# Regional Development and Policy in the Transition Countries

John Bachtler
Ruth Downes
Ewa Helinska-Hughes
John Macquarrie

**Regional and Industrial Policy Research Paper**

**Number 36**

**December 1999**

**Published by:**

**European Policies Research Centre**
**University of Strathclyde**
**40 George St.**
**Glasgow G1 1QE**
**United Kingdom**

**ISBN: 1-871130-14-X**

## Abstract

The paper examines the issue of regional development disparities and patterns evident in the transition countries of Central and East European (CEE) and the emerging regional policy response. The report focuses on five CEE countries – the Czech Republic, Estonia, Hungary, Poland and Slovenia – which were originally considered 'first-wave' countries for EU accession, before the negotiations were widened to all ten applicant countries towards the end of 1999. The report begins with a comparative chapter, highlighting the overall transition context and common trends in disparities and regional policy evolution. The remainder of the report is a comprehensive overview of regional policy developments in the five countries, based on a comparative structure which presents briefly the patterns of regional disparities before turning in detail to the evolution of regional policy, addressing issues such as the relevant territorial and administrative structures, the policy philosophy and direction, regional policy instruments and the assisted areas designated for their implementation.

## Acknowledgements

The authors gratefully acknowledge the contribution of those policy-makers and regional development actors interviewed in the relevant CEE countries as part of the research study. Further, the authors gratefully acknowledge the support of the New Professors' Fund, University of Strathclyde, Glasgow in the financing of the research.

**TABLE OF CONTENTS**

## 1. INTRODUCTION

The transformation of Central and Eastern Europe has created new spatial patterns of economic and social inequality. Whereas the capital cities are generally flourishing, with relatively low unemployment rates, high levels of new firm formation and concentrations of foreign investment, old-industrialised areas have suffered from the closure or rationalisation of outdated, inefficient enterprises. The reorientation of trade and investment patterns has disadvantaged many eastern areas, often suffering a combination of low agricultural productivity (partly exacerbated by privatisation), out-migration, poor infrastructure and environmental problems. In part, regional prosperity is related to factors such as proximity to EU borders, the quality of infrastructure and diversification of industrial and occupational structures. However, the ability of regions to adapt is also governed by deep-seated historical and cultural factors, ethnicity and the influence of central planning.

As market economic systems have become embedded, transition countries are increasingly aware of widening regional disparities and the need to provide preferential aid to problem regions. Virtually every country has prepared some kind of regional development concept but few have established the necessary legislative basis and complete institutional infrastructure for designing and implementing regional policy measures. Hungary established specific Ministerial responsibility for regional policy relatively quickly following political reform and, more recently, ministries, departments or agencies for regional development are operating in the Czech Republic, Slovenia, Estonia, Romania, Slovakia, Latvia and Bulgaria, although constrained by shortages of resources and expertise. The reform of territorial administrative structures is being widely debated and, notwithstanding recent proposals for devolving power to new regions in the Czech Republic and Poland, most countries are missing an intermediate regional tier of planning or government between the central and local administrations. Striking is the lack of clear governmental leadership for regional policy in Poland. Several initiatives have been launched by the former Central Office of Planning and the Polish Council of Ministers, including two high-profile ‘task forces’ on regional development and structural policy, and the Polish Agency for Regional Development co-ordinates a network of over 70 local development agencies. Political commitment to a national regional development policy has, though, proved difficult to achieve.

The post-liberalisation process of regional policy formulation has been strongly driven by the European Union. For several years, the programme has funded regional development initiatives in many transition countries, although with a relatively small share of the overall technical assistance budget. The initiation of enlargement negotiations has accelerated the process with the need to prepare institutional arrangements for managing EU structural assistance. The Agenda 2000 communication, published in July 1997, proposed a pre-accession strategy for all applicant countries including aid for agricultural development and structural aid for infrastructure and institutional adaptation worth 45 billion ECU.

The main concern about recent trends is whether sufficient thinking has been given to the kind of regional policy appropriate for Central and Eastern European countries at their present stage(s) of transition. In the rush to qualify for accession, there is little questioning of the relevance of the principles of the Structural Funds. Western Europe has long experience of regional policy but is itself undergoing fundamental shifts in paradigm and governance of regional development.

The following report examines regional development in the transition countries in detail, focusing on five of the leading accession countries. It reviews the dynamics of regional disparities and problems in Central and Eastern Europe, beginning with a comparative assessment of regional problems and policies across the region and then discussing the evolution of regional policies - the objectives, institutions and policy instruments that have emerged to date. Subsequent chapters then provide a series of country reports - for the Czech Republic, Estonia, Hungary, Poland and Slovenia - examining regional disparities, territorial administrative structures and regional policies in each country.

# 2. REGIONAL DEVELOPMENT IN THE TRANSITION COUNTRIES: A COMPARATIVE ASSESSMENT

## 2.1 Transition context

According to the European Bank for Reconstruction and Development and Economist Intelligence Unit surveys (EBRD 1997, 1998; EIU 1998), all Central and East European (CEE) countries have begun to recover from the steep declines in output of the early 1990s and GDP is now growing strongly with estimates of between 1.7 and nearly 6 percent GDP growth for 1999 (see Table 1). Economic growth is most strongly embedded in a group of 'leading' countries - Poland, the Czech Republic, Hungary, Slovenia and Slovakia - which have experienced positive growth rates for several years, by comparison with other states - the Baltic countries, Romania, Bulgaria - where GDP growth has only resumed over the past 2-3 years and (in some cases) inflation is still very high. Despite strong growth rates, the collapse in output in the early transition years was such that only Poland appears to have exceeded the 1989 level of GDP, and some countries - Latvia and Lithuania - still appear to have levels of GDP less than half the 1989 level. Inflation is still relatively high by Western European standards, forecasts for consumer price increases ranging from 7 to 18 percent (except for Romania and Bulgaria), but still represents major improvements on the high double and treble digit rates of 3 to 4 years ago.

The share of the private sector in GDP exceeds 40 percent everywhere, with figures of 75+ percent in the Czech Republic, Hungary and Slovakia (see Table 2). The privatisation of small-scale enterprises has been complete in several countries for some years with standards and performance typical of advanced industrial economies (ie. no state ownership and effective tradability of land and assets). Large-scale privatisation encompasses at least half of state-owned enterprises, and significant progress is being made in the corporate governance of enterprises in most countries - Romania and Bulgaria being notable exceptions where bankruptcy legislation and tight credit/subsidy policies has yet to be rigorously enforced. Substantial progress has been made with price liberalisation, although energy prices and some other basis commodity prices are still subject to control.

Internationally, CEE countries have become open economies, integrated into the world economy, reflected in markets for goods, services, capital and labour as well as in political-institutional participation in international organisations and agreements. The EU has replaced the Soviet Union as the most important trade partner for most CEE countries (with the exception of Lithuania, Latvia and Slovakia). Imports have been growing faster than exports in all the Central and Eastern European countries over the 1990-97 period leading to growing trade deficits, especially in Poland and the Czech Republic (see Table 1). Foreign investment flows are high and rising in most parts of the region, though most of the investment remains concentrated in Poland and Hungary. The EU review of candidate countries as part of *Agenda 2000* noted that substantial progress has been made in establishing 'single market' reforms (see), particularly in education, R&D, telecoms, SMEs and trade relations, although the rate of progress varies by country and sector.

Unemployment rates are generally rising throughout the region - ranging from 3.5 percent in the Czech Republic to almost 14 percent in Slovenia and Poland - but remain inadequate as a true indicator of labour market conditions. This is a result of factors such as the under-registration of hidden unemployment and ineligibility for benefits among those out of work for prolonged periods. Combined with the fall in average incomes, inequality of living standards is growing with a rise in poverty in most countries. The hardships associated with the transition process are reflected in the deterioration of many demographic indicators (falling birth rates, excess mortality, falling marriage rates) and popular dissatisfaction and pessimism as recorded in opinion poll surveys.

**Table 1: Selected economic indicators for CEE countries**

| | *Pop'n (mill)* | *GDP per capita (estimate) (US$)* | *GDP growth forecast (%)* | *Inflation forecast (%)* | *Unemploy-ment Estimate (%)* | *Current Account (projec-tion)* | *Foreign Investment (projec-tion)* |
|---|---|---|---|---|---|---|---|
| | *1997* | *1997* | *1999* | *1998* | *1997* | *1998* | *1998* |
| Czech Rep. | 10.3 | 5050 | 2.5 | 9.0 | 5.2 | -1700 | 1.0 |
| Estonia | 1.5 | 3230 | 5.7 | 8.0 | 10.5 | -576 | 0.2 |
| Hungary | 10.1 | 4462 | 4.9 | 13.5 | 10.4 | -1600 | 1.5 |
| Poland | 38.7 | 3512 | 5.6 | 10.0 | 10.5 | -6500 | 4.0 |
| Slovenia | 2.0 | 9101 | 4.5 | 7.0 | 14.4 | -80 | 0.2 |
| Bulgaria | 8.3 | 1227 | 4.0 | 10.0 | 13.7 | -100 | 0.3 |
| Latvia | 2.5 | 2211 | 5.2 | 4.6 | 7.0 | -514 | 0.3 |
| Lithuania | 3.7 | 2581 | 5.1 | 4.2 | 5.9 | -1563 | 0.8 |
| Romania | 22.5 | 1549 | 1.7 | 45.0 | 8.8 | -3400 | 0.9 |
| Slovakia | 5.4 | 3642 | 3.3 | 9.0 | 11.6 | -1950 | 0.2 |

Source: EBRD Transition Report, 1998. 1997 figures are estimates. GDP growth and inflation forecasts represent an average of forecasts from EBRD, EU, IMF, OECD, UNECE, EIU. PlanEcon, IWH, Kopint-Datorg, WIIW, CSFB, JP Morgan and Dun & Bradstreet. Current account figures are in US$ million. Foreign investment is net inflow in US$ billion.

## 2.2 Regional disparities and regional problems

As transformation proceeds, the uneven spatial impact of intense economic reform is becoming more apparent. The overall picture is one of widening disparities between and within countries. Research on regional differences in several CEE countries reveals that disparities have increased significantly since the start of transition, with a fragmentation of regional economies. Indeed, across Central and Eastern Europe: "the general tendency towards regional economic convergence during the 1948-89 period has clearly been replaced by a serious erosion of the potential for transformation in a large number of regions, while economic growth becomes increasingly concentrated in a small number of metropolitan core areas" (Dunford and Smith, 1998). The patterns of regional development between and within CEE countries are highly varied, but four inter-related types of regional disparity stand out: the contrast between urban and rural areas; a core/periphery disparity, especially in countries with a monocentric urban structure; a west/east difference, particularly evident in border areas; and concentrations of restructuring problems in old-industrial areas.

## Table 2: Progress with transition in selected CEE countries

| Criteria | Czech Republic | Estonia | Hungary | Poland | Slovenia |
|---|---|---|---|---|---|
| **Functioning market economy -** liberalisation, privatisation, stabilisation | achieved a successful stabilisation of economy | prices liberalised to a very large extent | progressed considerably, economy successfully stabilised | prices and trade have been liberalised to a large extent | achieved a successful stabilisation of economy, market mechanisms need improvements |
| **Economic and monetary union** (third stage) - coordination of economic policy, complete liberalisation of capital flows | should pose no problems | should pose few problems in the medium term | should be in a position to participate at the appropriate time | should pose no problems | difficulties with incompatibility of rules governing the central bank with those of EU, need to restructure banking sector |
| **Financial sector** | need strengthening, domination by few part-state-owned banks | healthy and expanding strongly | bank restructuring is well underway | underdeveloped, reforms needed | lack of competition |
| **Pension and social security reforms** | | not yet started | have to advance; deepening capital markets | need to be reformed | not completed |
| **Able to cope with competitive pressures and market forces within the Union** | change at the enterprise level must accelerate | export base must be broadened | macro economic conditions for strong investment growth must remain in place | have to maintain pace of restructuring and keeps the economy open | rigidities in the economy must be reduced |
| **Others** | skilled workforce, low value added, relatively good infrastructure and quality of exported goods, more enterprise restructuring to redress external imbalance needed | legal framework in place, slow land reform, low exchange rate & labour cost help exports, narrow export base, current account deficit, currency board & fiscal stance reduces inflation | good restructuring of industry and banks, competitive enterprises, have to avoid unsustainable budgetary or external deficits which hinder investment and restructuring | growth and investment are strong, moderate rise in labour costs. Problem of large uncompetitive state companies. | skilled workforce, slow enterprise restructuring, rapid wage growth and low productivity growth |
| **Foreign direct investment** | high | major recipient, although inflow decreased recently | high | has accelerated | low |
| **Work still needed to be done to establish the single market** | financial services, taxation | public procurement, intellectual property, financial services, taxation, competition, transparency of state aid | standardisation | public procurement, data protection, competition and liberalisation of capital flows, technical rules and standards | public procurement, competi-tion, insurance, free capital flows, product conformity, standardisation, VAT |
| **Substantial progress has been made to establish the single market** | administrative infrastructure | company law, accounting, data protection, capital liberalisation | competition, public procurement, intellectual property, company/ accounting law, taxation, product liability, financial services, legal base | intellectual property, company law, taxation, accounting, financial services, administrative infrastructure | |
| **No difficulties to establish the single market** | education, R&D, telecoms, SME, inter. trade relations, development, statistics. | education, R&D, audio-visual, SME, trade relations, development | education, R&D, telecoms, audio-visual, SME, consumer protection, trade, customs | education, R & D, SME, development, customs, statistics | education, R&D, telecoms, audio-visual, SME, consumer protection, trade, customs |
| **Substantial effort needed to establish the single market** | customs, audio-visual | admin., statistics, fisheries, consumer protection, customs. | consumer protection, custom control | consumer protection, telecommunications, fisheries | |

Source: Institute of Macroeconomic Analysis and Development (based on Agenda 2000)

In all of the transition countries, the major agglomerations and urban centres are leaders in the transformation process. Most prominent is the dominant role of core and capital city regions; indeed, in countries such as Hungary, the Czech Republic, Estonia and Latvia there is no centre which rivals the capital city. In the *Czech Republic*, Prague is the only region with GDP above the national average, and the disparity between the capital and remaining Czech regions is increasing; all other regions have GDP below the national average. A similar story applies to *Hungary* with increasing disparity between Budapest and the remainder of country. Budapest accounts for 40 percent of the total urban population (with c. two million inhabitants, compared to the next largest centre which has only 200,000), 35 percent of service sector employment, and an unemployment rate less than half the national average. In the mid-1990s, Budapest had more joint ventures than the rest of the country combined and accounted for nearly two-thirds of all FDI flowing into the country. The situation in *Estonia* is still more extreme: Tallin has 40 percent of all registered enterprises, 78 percent of foreign-owned private enterprises, 87 percent of all foreign capital, and 93 percent of foreign visitors to Estonia. The lack of rival centres/regions in all three countries is reflected in the relatively equal rates of growth and development beyond the core: inter-regional disparities outside the capitals of Hungary, Estonia and the Czech Republic appear to be stable or decreasing.

*Poland* has a more polycentric settlement pattern, although Warsaw still has more favourable economic indicators; unemployment in the capital was only two percent in 1997, compared to the maximum regional rate of 21 percent. Reflecting the less dominant position of Warsaw, other large Polish cities also show positive economic indicators - the highest levels of economic development (per capita GDP exceeding the national average) are observed in voivodships containing large urban centres. Nine urbanised voivodships (Katowice, Warsaw, Poznan, Gdansk, Krakow, Bydgoszcz, Szczecin, Wroclaw and Lodz) produce around half of Poland’s GDP.

Lastly, in *Slovenia*, the urban/rural contrasts have a different dimension, perhaps more comparable with the Nordic countries. The topography of the country means that 75 percent of the population live on one-fifth of the territory; ‘de-populating areas’ account for around 40 percent of the territory where average population density is below 35 inhabitants per $km^2$ (national average is 100 people per $km^2$). Central Slovenia, which includes the capital, Ljubljana, together with north-western regions, generally have better economic indicators than the rest of the country, but disparities are not as marked as in other parts of CEE.

The dominance of the capital cities partly reflects historical factors, for example the effects of the break-up of the Austro-Hungarian empire (leaving large cities in small countries), although under socialist planning, rapid industrialisation was associated with urbanisation in less-developed regions and an effort to spread urban/industrial growth. The capitals and other major urban centres have had the concentrations of infrastructure (international airports, telecoms), business services (financial institutions, producer services), access to key decision-makers, skilled workers, and higher standard accommodation and retail facilities which have given them undisputed advantages in the transformation process.

It is in the urban areas that the most advanced features of transition are evident; across CEE, new firm formation and entrepreneurial activity is particularly high in the larger centres. Foreign investment is heavily concentrated in the cities; much of the higher value foreign investment in high-tech sectors of financial and business services is almost exclusively located in the capitals and other metropolitan centres. Urban uemployment rates have generally been the lowest - unemployed people have been more likely to become self-employed, especially in the retail sector - and indeed the labour markets in urban centres show some evidence of shortages of workers, requiring immigration from neighbouring countries. A key feature of transition has been the catching-up growth of the (formerly tiny) tertiary sector which has also implicitly favoured capital cities and main urban centres.

**Table 3: Housing/labour market transformation by settlement type**

| Housing Market | Labour Market |
|---|---|
| **Metropolitan Areas** | |
| • social-ecological quality again becoming a factor in rental values<br>• delayed processes of city formation with respect to investment patterns of shops and businesses<br>• replacement of living quarters with businesses | • catching up process of tertiarisation<br>• new firm formation<br>• investment by foreign firms/entrepreneurs<br>• compensatory job growth<br>• low unemployment<br>• new segmentation of labour market<br>• increase in income disparities |
| **Small and Medium-Sized Towns** | |
| • weaker city formation<br>• minimal effects on real housing market situation<br>• weaker process of segregation<br>• symptoms of decline in conjunction with de-industrialisation | • stronger de-industrialisation<br>• weaker process of tertiarisation<br>• investment by foreign firms only in exceptional cases<br>• insufficient compensatory job growth<br>• high unemployment |
| **Rural Areas** | |
| • minimal effects on real housing market situation<br>• on the basis of the unfavourable labour market situation, ‘devaluation’ of house ownership still evident<br>• high usage, low exchange value<br>• low turnover of premises<br>• high level of empty occupancy<br>• symptoms of decline | • no return of family businesses<br>• no notable expansion of non-agricultural activity<br>• little interest of foreign capital<br>• ‘buffer function’ of agriculture<br>• high unemployment<br>• closed labour market<br>• out-migration |

Source: Fassmann (1997)

In contrast to the many positive economic and employment changes in the cities are the physical planning and housing market difficulties being encountered, summarised in Table 3. (Fassman, 1998). The attractiveness of the major urban areas for foreign investment, combined with the privatisation of housing, has caused a steep rise in rents and the restratification of social groups within cities to create a new residential geography. Recent research on housing privatisation suggests that social inequalities are developing rapidly, with unemployed residents particularly disadvantaged. Societal distribution patterns of post-communist cities are moving towards western models of polarisation (Grime *et al*, 1998). Further difficulties, relating to the rapid economic development of the capital cities in particular, are associated pollution and congestion-related problems.

Beyond the cities, as indicated in Table 3, the economic benefits of transition are not being shared by many rural areas, characterised by increasing unemployment and falling employment opportunities within and outwith agriculture. The privatisation of agriculture has, in some CEE countries, left farmers in a very precarious position. There has been a partial return to subsistence farming on small, uneconomic plots, lacking fertilisers and other costly resource inputs, and unviable for mechanised farming. The ‘playing field’ for competition is not always fair with the remaining State-owned farms still receiving preferential government support, and with agricultural supply or marketing enterprises still under State control. Alternative employment opportunities are often limited or non-existent, foreign investment is lacking and unemployment rates are consequently high. In Poland, where there is an unusually high proportion of total employment in agriculture (26 percent in 1997), rural areas dominated for many years by State agriculture (eg. north-west Poland) have suffered above average rates of unemployment; the north-west region’s present economic difficulties result directly from the collapse of State farms, which were the crucial element of the rural economy.

Demographic factors also play a part. Depopulation and out-migration are characteristic of some rural and underdeveloped agricultural regions. Migrants are often the younger or better qualified people who rarely return, exacerbating already imbalanced age-sex structures. The problem of an ageing population in a number of countries (Slovenia, Czech Republic, Hungary) tends to be concentrated in rural and peripheral areas.

There is an important west-east dimension to the above discussion, especially as far as the peripheries of the CEE countries are concerned. Whereas from an EU perspective the EU-CEE border is seen in terms of regional disadvantage (due to the steep income differences between Germany or Austria and neighbouring Poland, Hungary and the Czech Republic), for the transition countries it presents new opportunities (Schamp, 1994). In the pre-transformation period, the western border areas of CEE were in an unfavourable position (*tote Grenze)* and neglected under socialist planning, but since 1989 they have been able to take advantage of inflows of productive investment, tourism, cross-border shopping and cross-border economic development initiatives. The result is low unemployment, rising wage levels and in-migration as well as stimuli for the housing market and construction industry (see Table 4).

For the eastern peripheries of CEE the situation is reversed. Termed the ‘eastern wall’, the eastern border regions tend to have relatively poor infrastructure, little investment and unfavourable economic structures - a predominance of agrarian activity, high unemployment, low educational attainment and low qualifications among the labour forces and unfavourable age structure. Opportunities for cross-border economic stimuli from the Ukraine and Byelarus are relatively limited, although economic links and development opportunities are slowly being encouraged. Special border problems exist on the southern border areas of Slovenia which adjoin still volatile areas of the former Yugoslavia; these areas have had to re-orient previously internal Yugoslav linkages to ‘international’ relations with their neighbours, complicated by war and unrest.

**Table 4: Transformation characteristics in western border areas**

| Housing Market | Labour Market |
|---|---|
| • replacement of living quarters with businesses<br>• conversion of housing units into second homes | • new firm formation (joint ventures, wage improvement)<br>• growth of services sector<br>• migration and commuting in east-west direction |
| • increase of ground and property prices<br>• stimulated construction industry<br>• improvement in regional economic cycles | • low unemployment<br>• new segmentation of labour market<br>• raising of wage levels<br>• reduction of wage disparities with western countries<br>• labour shortages |

Source: Fassmann (1998)

Finally, it is important to mention the industrial problem areas of CEE. Like their counterparts in western Europe, they have the highest unemployment rates and large numbers of the most difficult (to reintegrate) groups of unemployed eg. low qualified, long term unemployed. In the socialist period, the heavy industrial regions were the ‘drivers’ of economic development but have been severely affected by privatisation and enterprise restructuring, the reorientation of trade from formerly secure markets and the loss of subsidies. Severe degradation of the environment, in terms of air, water and ground pollution, was often associated with the massive scale and poor technology of industrial production in these areas. Although pollution may have been reduced by the rationalisation of enterprises or new investment, the environmental legacy still presents major costs of clean-up and land reclamation.

In Hungary, three eastern, industrial counties account for over 35 percent of the country’s total unqualified, unemployed workers. Disparities are often very high, as in the Czech Republic where old industrial regions have unemployment rates of ten percent, twice the national average. Comparable regions in other countries include Ida-Viru and Valga in Estonia, Northern Bohemia and Northern Moravia in Czech Republic, Szabolcs-Szatmár-Bereg and Borsod-Abaúj-Zemplén in Hungary, Upper Silesia and Walbrzych in Poland, and Zasavska, Podravska and Posavska in Slovenia. Upper Silesia in Poland faces probably the most difficult industrial restructuring process compared with industrial regions in other CEE countries. In an agglomeration of four million people, 800,000 are employed in endangered sectors; restructuring is likely to lead to a dramatic increase in unemployment and a zero or even negative growth rate (Gorzelak and Jalowiecki, 1997).

Against a background of widening regional disparities and fragmentation of regional economies, the following sections review the policy response of CEE governments, beginning with an outline of territorial administrative structures and regional development institutions before examining the objectives and instruments of regional policy.

## 2.3 Territorial administrative structures

The territorial administrative structures of CEE countries are highly varied in terms of the hierarchies of territorial unit, the number and size of administrative units and the form of administrative organisation. In the pre-transformation period, territorial organisation was arranged to facilitate central planning and fragment potential power bases of political opposition. In the wake of transformation, several processes affected territorial and administrative structures (Gorzelak 1996).

- A fragmentation of territorial units took place as localities sought to (re)gain control over local settlement affairs. In Hungary, the local government reform act of 1990 introduced a 'one settlement, one local government' principle, doubling the number of municipalities to over 3,000, over one-third of which have fewer than 500 inhabitants. In the Czech Republic, more than 2,000 new municipalities were created (to produce more than 6,000 municipalities), 80 percent with a population of under 1,000, and in some cases with only 50 inhabitants. In several countries, many municipalities are too small for any economic development functions apart from the delivery of basic services. The fragmentation process was less pronounced in Poland where the 2,483 municipalities are larger (very few have under 2,500 inhabitants) and are regarded as stronger economic and legal entities. Both Slovenia (192 municipalities) and Estonia (209 municipalities and 45 towns and cities), as small countries, have far fewer units of local self-government - although proportionally these units are still very small and thus are still examples of the above trend.

- Intermediate regional or district administrative units were abolished or downgraded. The eight Czech regions were abolished in 1991 while in Hungary the six regional State Representatives of the Republic were abolished in 1994 and the county role in state administration was severely weakened, mainly because of its association with former State bodies.

The outcome of these processes is a vacuum between central and local government. There is general agreement that an intermediate 'regional' level is required but dispute over the appropriate territorial division. In the interim, regional development is currently being conducted by the deconcentrated or regional representatives of central government ministries as well as networks of regional and local development agencies (again largely responsible to central government). It is perhaps an irony that, despite political transformation moving away from centralised structures, the current institutional systems for regional policy remain highly centralised. The current situation in each country is as follows.

- *Estonia*. The country is divided into 15 administrative counties plus the City of Tallinn. County governors are appointed by the State and represent central government in the counties, implementing central government policies including regional development.

- *Czech Republic*. There are 77 districts (including Prague). They are responsible for State administration including regional development function. Legislation passed in December 1997 will create 14 new administrative regions from 1 January 2000; it is currently unclear whether the number and competencies of the existing districts will remain the same.

- *Hungary*. The country is divided into 20 counties (including Budapest). The counties are legally responsible for services which affect the county when settlement local authorities do not (wish to) undertake them. The deconcentrated organisations of central Ministries and administration generally operate at county level and have taken over some of the duties formerly undertaken by county councils under the socialist regime.

- *Poland.* From 1 January 1999, Poland has been divided administratively into 16 *voivodships*. This new structure, based on legislation passed in August 1998, considerably reduces the number of *voivodships* from the previous total of 49. The new *voivodships* are much larger, though they are not just an amalgamation of the existing regions, but entirely new entities. Reform will re-establish the most effective and best integrated administrative unit from the past, the *powiat* (district).

- *Slovenia.* The country is divided into 192 municipalities. Deconcentrated organisations of the central government operate within various different regional frameworks, varying generally between 8-12 regions.

**Table 5: Current territorial and administrative structures in CEE**

| **Country** | **Regions** | | **Counties/districts** | | **Municipalities** | |
|---|---|---|---|---|---|---|
| | *No.* | *Type* | *No.* | *Type* | *No* | *Type* |
| *Czech Rep* | - | - | 77 | Districts | 6,000 | Municipalities |
| *Estonia* | - | - | 15 | Counties | 254 | 45 cities & towns, 209 municipalities |
| *Hungary* | - | - | 20 | Counties | 3,000 | Municipalities (settlements) |
| *Poland* | 16 | *Voivodships* | 373 | Counties (*powiat*) | 2,489 | Municipalities (*gmina*) |
| *Slovenia* | - | - | - | - | 192 | Municipalities |

### 2.4 Institutional developments

The challenge for institutional structures throughout CEE following political and economic reform has been a reorientation to market economic requirements. The former dominance of sectoral ministries under socialist planning is being progressively adapted to develop appropriate institutional arrangements which enable administration of regional economic development in changing spatial conditions. From a position, a few years ago, when institutional arrangements for regional policy were non-existent or *ad hoc,* the institutional infrastructure for regional development in CEE is now developing at an accelerating rate. At national and regional levels new structures, agencies and co-ordination mechanisms are being created.

First, with the notable exception of Poland, institutional responsibility for regional policy has been allocated to a single government department. There is little consistency in the ministerial allocation, regional policy being variously run by ministries of the interior, economics and agriculture (See Table 6). This reflects the influence of political factors - as in the shift of regional policy from the environment ministry to the agriculture ministry in Hungary following the recent elections, and the problems experienced in Poland in agreeing single-ministry responsibility for regional development. It also depends on the role of regional policy, as in Estonia where one of the objectives of regional policy is to maintain national territorial integrity and where regional policy is the responsibility of the Ministry of Internal Affairs. A relatively unique approach, in both Western and Eastern Europe, is the creation of a specific Ministry for Regional Development in the Czech Republic. Although in Czech, the name, *Ministerstvo pro Místní Rozvoj,* refers to local rather than regional development[1], the creation of this new ministry in 1996 (taking over responsibility for regional development from the former Ministry of Economics) was an explicit signal of the greater importance attached to the policy area following the 1996 government elections in the Czech Republic.

**Table 6: Summary of institutional structures for implementing regional policy**

| **Country** | **Ministry** | **National implementation bodies** | **Sub-national bodies** |
|---|---|---|---|
| *Czech Rep* | Regional Development | Centre for Regional Development<br>Bohemian-Moravian Development Bank | Regional development agencies |
| *Estonia* | Internal Affairs | Council of Regional Policy<br>Estonian Regional Development Agency | County governments |
| *Hungary* | Agriculture & Regional Development | National Regional Development Council | Regional Development Councils<br>Country Development Councils |
| *Poland* | No specific ministry[2] | Polish Agency for Regional Development<br>Government Centre for Strategic Studies | Regional development agencies |
| *Slovenia* | Economic Relations & Development | | |

[1] The ministry also has responsibility for housing policy, municipal development and spatial planning.

[2] In 1998 a Department for Regional Development was created within the Ministry of Economy. As yet it is unclear how it will function especially in relation to the Ministry of Finance and the Office of the Committee for European Integration.

The allocation of EU structural support has significantly strengthened the recognition given to regional policy and the control over future budget flows has been subject to ministerial rivalry and dispute over the past year. Nevertheless, in general, regional policy is still a comparatively weak area of policy in terms of political profile or priority, and is therefore more readily subject to political trade-offs and institutional reorganisation following elections or ministerial reshuffles. The prime example of this situation is Poland where regional policy has been fought over by the ministries of economy, finance, labour and agriculture as well as the Office of the Committee for European Integration (in the Council of Ministers).

Second, formal inter-ministerial co-ordination mechanisms are becoming an important component of the institutional arrangements for administering regional policy, much moreso than in most Western European countries. While the creation of such mechanisms may be positive for coordinating policy, their operational effectiveness cannot yet be ascertained.

- *Hungary* has created a National Council for Regional Development to prepare regional policy decisions and co-ordinate activities between national ministries, country development councils, national economic chambers, national-local government partnerships, foundations and academic organisations.

- *Estonia* has a Council of Regional Policy representing all ministries, the county governments and local self-governments, with responsibility for co-ordinating sectoral policies and advising the cabinet and different ministries on regional development issues.

- *Slovenia* is proposing to create a National Regional Development Council (in the draft bill on the ‘Promotion of Regional Development in Slovenia’) to co-ordinate central government spending on regional development and to consult with relevant organisations at national and regional/local levels.

- In *Poland*, the creation of a new department for regional development within the Ministry of Economy in August 1998, and of a new Committee for Regional Policy within the Council of Ministers in September 1998, indicates that the Polish government is attempting to address the issue of inter-ministerial co-ordination, although the effectiveness of the arrangements is currently unclear.

Apart from the countries discussed in this report, a similar trend can be observed in other transition countries. In Romania a new institutional structure for regional policy will have, at its apex, a new National Regional Development Board (NRDB) to establish a framework for regional development across the country including the elaboration of a National Regional Development Programme and National Regional Development Fund. Membership of the NRDB comprises ministries and central government bodies, agencies, commissions, non-governmental organisations, business associations and regional representatives. In Latvia, an inter-ministerial Regional Development Council has been established to define regional development strategy and other aspects of regional policy design (area designation, eligibility criteria, monitoring and evaluation); and in Lithuania a National Regional Development Council acts as an interface between central government ministries (especially finance, public administration and environment) and agencies, county authorities and interest groups.

Third, several countries have created separate organisations - at central government level - to support the design and implementation of regional policy. These fall into two groups. One set of organisations comprises institutes or centres established to assist with the policy design or information dissemination functions. In the Czech Republic, the *Centre for Regional Development* operates within the Ministry for Regional Development (and through a network of branch offices) to provide support services - especially information and training - for sub-national agencies on regional policy matters. The *Governmental Centre for Strategic Studies* in Poland (taking over from the former Central Office of Planning in 1997) is responsible for analysis of regional development issues and preparation of the government's 'spatial policy' but does not have operational responsibilities. The Slovenian *Institute for Macroeconomic Analysis and Development*, part of the Ministry responsible for regional policy, is another example of a policy support and advice unit.

Another category of central organisations has been created to manage or co-ordinate the implementation of regional policy. One of the longest running agencies is the *Polish Agency for Regional Development* (PARR) established in 1993 and specialising in the administration of regional development programmes, largely funded by Phare (STRUDER, RAPID, STRUDER II, INRED) and other donor agencies. It also works with many of the c.70 regional development agencies established at local/regional levels in Poland over the past 6-7 years. More recently, the *Estonian Regional Development Agency* was set up to work on behalf of four government ministries with regional development interests (internal affairs, economics, agriculture, environment) as well as counties, local government and business associations. The ERDA manages regional policy activities, for example the administration of regional development programmes and incentive instruments, and assists other regional development organisations with technical support. The Czech Republic has the *Bohemian-Moravian Guarantee and Development Bank* to administer the main instruments of regional assistance.

Lastly, an increasingly dense network of sub-national regional development bodies is emerging. Under the 1996 regional development legislation in Hungary a two-tier system of sub-national co-ordination of regional development comprises:

- county development councils, with the remit of co-ordinating regional policy tasks in each of the 19 counties, by involving local governments and other bodies in planning development strategies and distributing regional policy funds; and

- regional development councils, with the remit of producing regional development plans for each of the seven regions, and acting as an interface for government ministries, economic chambers, county and local government representatives.

A similar approach has been taken in Estonia where county governments are responsible for co-ordinating all regional level sectoral policy activities eg. business support, tourism, public services, strategic planning. In Slovenia, the lack of an intermediate regional tier poses problems in this regard but new proposals under the draft regional strategy foresee the creation of regional development agencies which would co-ordinate national policy measures and bottom-up municipality initiatives.

Whereas Hungary, Estonia, and Slovenia have essentially taken a 'top-down' approach to creating sub-national implementation structures, the reverse is the case in Poland. The absence of national regional policy institutional leadership and also the weakness of public institutions at the voivod level led to the 'bottom up' creation of regional development agencies (c.70 in 1998) by varying combinations of regional and local partners. They have attempted to fill the vacuum between public administration and the private sector in economic development tasks and to generate new financial resources. Furthermore, in recognition of the need for exchange of experience and co-ordination of their activities at national level, regional development agencies established the National Association of Regional Development Agencies.

## 2.5 Regional Policies

Regional policy is not a totally new phenomenon in CEE. Spatial planning within a sectoral framework was undertaken during the socialist years, and regional policy actions along western European lines was undertaken (to a limited extent) in some countries with a more liberal economic approach eg. Hungary and Slovenia. There is also a long and rich intellectual tradition of debate and research on regional development in CEE. In some ways, therefore, current trends have to be seen as part of a longer term history of regional development in CEE, albeit affected considerably by fundamental political, economic and institutional systemic changes.

Nevertheless, a market economy based regional policy has been slow to develop in CEE. After 1990, priority was initially given to political reforms and macroeconomic policies; the social and spatial consequences of transformation took time to emerge and scarce resources were needed from national economic recovery from the catastrophic collapse in output noted above. Further the institutional infrastructure for regional policy was lacking. Regional development initiatives were hampered by disputes over ministerial responsibility, the need to reform territorial administrative structures and the lack of financial resources. Successive comparative assessments of the regional development situation in the various CEE countries during the first half of the 1990s indicated limited emergence of substantive regional policies, weak regional development institutions and unresolved issues of territorial administration (Bachtler 1991, Gorzelak and Kuklinski 1992, Hajdu and Horvath 1994, Downes 1996, Gorzelak 1996, Bachtler *et al* 1997).

Over the past two years, this situation has changed significantly. Regional policies are now operating (albeit on a small scale) in almost every CEE country, institutions are being created at national and regional levels, and a range of policy instruments exists. The following sections examine the objectives, instruments and spatial coverage of these policies in more detail.

### 2.5.1 *Policy objectives*

The objectives of regional policy in CEE are rarely specific (see Table 7). In particular, they generally lack an explicit conceptual foundation or theoretical base. Instead there is a preference for defining regional policy in terms of a mix of practical tasks (eg. restructuring old-industrial regions) or principles (eg. encouraging regional and local initiative). Policy objectives tend to encompass both efficiency and equity. Regional policy is expected to help secure transformation processes by "assisting the development of a market economy in every region" or "optimal economic growth in all regions", but also to ensure "reliable living conditions in all regions in terms of employment, basic services and a clean environment". Equally regional policy is intended to reduce regional disparities (core/periphery, east/west, urban/rural) or focus on particular regional problems - assisting areas of industrial restructuring, conversion of state-owned farms, support for border areas. The National Concept for Regional Development in Hungary is perhaps the best example (although it applies to the Czech Republic, Estonia and Poland to varying degrees): the National Concept presents a plethora of objectives, principles, guidelines and tasks which appear confusing, contradictory and wildly ambitious given the limited resources and political priority of the policy area in Hungary.

Slovenia is the exception. Reflecting limited regional disparities in what is anyway a small country, regional policy is highly focused on the support of demographically endangered areas - essentially upland, rural areas - where policy measures are intended to improve working/living conditions, promote additional income opportunities and establish a more socially attractive environment, all with the aim of reducing or reversing outmigration, especially of young people. There are, however, difficulties associated with this quite narrow approach, particularly related to the exclusion of regions undergoing industrial decline. A more integrated approach is proposed under the new draft law on regional development and policy.

The mix of objectives can be attributed to several factors. First, while regional disparities are growing and concentrations of extremely severe economic/social/environmental problems exist, there are few regions outside the capital cities where self-sustaining economic growth and development can be taken for granted. Most areas of CEE need investment in physical infrastructure and (equally importantly) an adequate business infrastructure to support entrepreneurship and SME development. Therefore, while central government needs to focus regional assistance on the worst regional problems it also faces regional development challenges in virtually every region.

Second, the CEE countries generally lack regionally based and resourced economic development action and are highly reliant on central government for support. In western Europe, central government authorities have been able to operate highly focused regional aid policies (giving prominence over the past 20 years to assistance to enterprises for capital investment and employment creation) with many of the 'business environment' or 'economic infrastructure' requirements being addressed by regional authorities or local governments. By contrast, in CEE regional authorities are non-existent and local government is weak. National government is therefore having to undertake both regional policy and regionalised economic development policy.

Third, the influence of the European Commission is very visible in the design of regional policies, with legislation and policy objectives drafted with a view to satisfying the real or perceived requirements of the EU's structural policies. In several countries (Czech Republic, Hungary and the draft Slovenian proposals - also Romania), regional policy legislation explicitly refers to the need for regional policy to be "compatible with the Structural Funds". At the outset, the Hungarian National Concept, like similar documents elsewhere in CEE, gives prominence to regional policy being based on partnership and the programming principle.

## Table 7: Regional policy objectives

| **Country** | **General concept/definition** | **Specific objectives** |
|---|---|---|
| Czech republic | No explicit concept/definition of regional policy. Law 272 of 1996 referred to the tasks of regional policy being the development of an "integrated economic and social development model….focusing on industrial conversion, skills development and rural development" *(Ministry of Regional Development)* | |
| Estonia | Regional policy "is a deliberate policy, pursued by the public authorities, aimed at creating the conditions necessary for balanced socio-economic growth of all regions of the country considering both regional as well as national interests" *(Department. of Local Government & Regional Development)* | • to provide reliable living condition in all regions (employment, basic services, clean environment)<br>• to promote optimal economic growth in all regions<br>• to ensure sustainable development<br>• to promote national territorial integrity, an even regional population and stable settlement development dynamics |
| Hungary | Overall aim combines national efficiency and mitigation of regional inequalities. Long-term goal is: a proportional development of the whole country, improving living standards, social and economic opportunity and infrastructure conditions, while improving the situation of backward regions *(National Regional Development Concept).* | • to assist the development of a market economy in every region<br>• to create conditions for self-sustaining development<br>• to reduce regional disparities, especially between the capital and country, between east and west Hungary, and between developed and backward regions and settlements<br>• to encourage regional and local initiatives, co-ordinated with national aims |
| Poland | No explicit concept/definition of regional policy. Official documents emphasise: restructuring of old industrial regions. counteracting structural recession in sub-regions with large state-owned farms; economic rejuvenation of eastern Poland; reconversion of mono-factory towns; and crossborder cooperation | |
| Slovenia | Regional policy is aimed at supporting rural and 'demographically endangered areas'. | • to improve working/living conditions in rural areas and maintain population<br>• to promote the creation of additional income opportunities in rural areas<br>• to establish a more socially attractive environment in outmigration regions |

### 2.5.2 Instruments

The lack of clarity in the definition of regional policy objectives also makes it difficult to identify specifically 'regional' economic development instruments. As in Western European countries the majority of regional spending is provided through sectoral policy budgets, several of which have a bias towards particular regions by virtue of the distribution of population, economic activity, physical infrastructures or social conditions. However, it is possible to distinguish between two types of instrument:

- regional development programmes, provided to municipalities or agencies for economic development purposes; and
- regional aid schemes, awarded directly to enterprises, usually SMEs.

The overwhelming share of regional policy support is provided through regional development programmes (see Table 8). These instruments tend to be directed at most or all regions of the CEE countries apart from the capital. Funds tend to be disbursed through central government representatives of the State (eg. regional offices of national government ministries, development agencies or country governments) or directly to municipalities. Programmes cover a wide range of economic development activities including employment creation, physical infrastructure (energy, telecoms, transportation), social infrastructure (health and education services), business development (industrial estates, business parks, incubator/innovation centres, information/advice centres), environmental improvement and tourism.

The longest running programme is the Regional Development Fund in Hungary. Created in 1991 it was the first State fund to be created for regional infrastructure development and job creation. Funds were awarded through a mix of non-repayable grants, loans and interest rate subsidies accorded to a regionally differentiated system of development priorities. In the mid 1990s the RDF was replaced by new budget lines from the State budget - the *Targeted Budgetary Allocation for Regional Development (TBARD)* and the *Spatial Equalisation Financial Assistance (SEFA).* As explained in more detail in Section 5 of this paper, the TBARD provides several different types of assistance (grants, loans, interest subsidies) for various economic/social infrastructure projects undertaken through integrated regional programmes, bringing together the resources of different sectoral ministries in various categories of area - underdeveloped areas, declining industrial areas, rural areas and high unemployment areas. The SEFA programme provides support projects undertaken by local governments in 'priority areas' determined by the County Development Councils.

**Table 8: Regional Policy Instruments - regional development programmes**

| Country | Programmes |
|---|---|
| Czech Rep | Regional support programmes for individual regions |
| Estonia | Programme for peripheral areas<br>Programme for mono-functional settlements<br>Programme for islands<br>Programme for the Setumma region (eastern Estonia)<br>Programme for south-eastern Estonia<br>Programme for north-eastern Estonia (Ida Viru)<br>Programme for the border region<br>Programme for rural and community development |
| Hungary | Targeted Budgetary Allocation for Regional Policy (TBARD)<br>Spatial Equalisation Financial Assistance (SEFA) |
| Poland | State budget special funds |
| Slovenia | Targeted regional development budget line and Regional Development Fund support for municipalities in demographically endangered areas |

Whereas in Hungary the main regional development programmes are operated on a standard basis across the country - differentiation depending on the resources awarded to each county and the priorities established at sub-national level - the Estonian approach has been to create separate regional programmes. The eight regional development programmes in Estonia are targeted at: peripheral areas; mono-functional settlements; islands; the Setumma region (in eastern Estonia); the south-eastern region; north-eastern Estonia (Ida Viru); border regions; and rural and community development. The Estonian programmes are administered by the Estonian Regional Development Agency and provide development grants for local authorities and non-governmental organisations for a wide range of physical, economic and social infrastructure purposes. In Slovenia, grants and loans are provided to municipalities on the basis of open tender from a central government administered budget line. This is principally for the co-financing of basic infrastructure investment but can also support the elaboration of development programmes and social service measures. The government also created a Regional Development Fund in 1995 (from privatisation receipts) which provides low interest loans and guarantees for SME and small agricultural investment in the assisted areas. Lastly, Poland and the Czech Republic provide a mix of financial instruments, technical infrastructure support and business environment assistance for the creation of economic development programmes in problem areas.

A universal feature of the programmes in all countries is that the government support must be co-financed: in Hungary, TBARD support provides aid of between 15 and 70 percent of eligible costs according to a complex matrix of eligibility by aid type and area; in Slovenia, the share of the State grant cannot exceed 30 percent of total investment (50 percent in border areas).

The second type of regional assistance comprises aid to enterprises. By comparison with western European countries, where the focus of regional aid is on grants, the CEE countries favour loans, interest-rate subsidies and tax incentives (see Table 9).

The reasons for this approach are mainly threefold. First, the financial resources are generally not available to provide non-repayable subsidies to enterprises. Second, the institutional infrastructure is not yet in place to enable government authorities to appraise, award and monitor grant aid. Instead, regional policymakers are largely using financial institutions (eg. the Bohemian-Moravian Guarantee and Development Bank in the Czech Republic) to provide low-interest loans or the tax system to provide regional tax relief. Assistance is primarily directed to small and medium-sized firms, generally in designated assisted areas. A third factor may be a conceptual or political aversion to grant aids. Several countries (eg. Estonia, Slovenia) have stated that regional policy should avoid giving grants to enterprises as part of the process of reducing industrial subsidies and promoting a market-oriented mentality among entrepreneurs and business managers.

**Table 9:Regional Policy Instruments - regional enterprise support schemes**

| Country | Schemes |
|---|---|
| Czech Rep | REGION - interest rate subsidy for SMEs in structural change districts<br>ROZVOJ (Development) - interest rates rate subsidy for SMEs in structural change districts<br>PREFERENCE - loan support for small firms in structural change areas<br>VILLAGE - SME formation and development support in smallest villages<br>REGENERATION - business support in heritage zones, reserves and sites |
| Estonia | Regional Development Loan<br>Regional tax incentives |
| Hungary | Regional tax incentives |
| Poland | Regional tax incentives (special economic zones) |
| Slovenia | Tax concessions; soft loans for business investment |

Expenditure on regional policy (see Table 10) is difficult to establish, and the available figures should be compared with great caution: they are based on national interpretations of ‘regional policy’ and cover different expenditure items. The data suggests that expenditure may range from 8 MECU (Estonia) to 82 MECU (Hungary). As a percentage of GDP, this may be equivalent to a range of 0.03 - 0.2 percent of national GDP, and implying per capita expenditure of 1.3 - 8.0 ECU.

**Table 10: Expenditure on regional policy in CEE**

| | | Expenditure | | Expenditure | Per capita expen- |
|---|---|---|---|---|---|
| | Year | Nat. currency | MECU | as % of GDP | diture (ECU) |
| Czech Rep | 1997 | 497 million crowns[a] | 14.3 | 0.03 | 1.4 |
| Estonia | 1998 | 136 million kroons | 7.9 | 0.2 | 5.3 |
| Hungary | 1997 | 20 billion forints | 82 | 0.2 | 8.0 |
| Poland | 1998 | 220 mill zloty | 54 | 0.05 | 1.3 |
| Slovenia | 1997 | 2170 mill tolars | 11.4 | 0.07 | 5.7 |

[a] ‘Region’ programme budget (ca. 60 percent of total regional policy budget)

### *2.5.3 Area designation*

The final aspect of regional policy covered here relates to the spatial coverage of policy. In every CEE country some form of area designation procedure is used either to identify the eligibility of areas for support programmes or to determine financial allocation to regions. Some CEE countries have a greater tradition of area designation prior to political liberalisation than others; Hungary and Slovenia both operated a system of designated assisted areas prior to 1990. In Slovenia, the 1990 designated areas are still in force, whereas Hungary changed its approach during the 1990s. Legislation in 1993 defined four categories of regional development area:

- backward settlements defined using socio-economic criteria;
- settlements located in backward regions (based on socio-economic criteria) but not backward in themselves;
- settlements where unemployment was at least 1.5 times the national average; and
- settlements requiring modernisation, based on a combination of the above criteria.

Over the 1996-98 period a more complex area designation system was introduced in Hungary drawing on EU practice and experience. The designation system moved from the ranking of settlements to assessing countries and statistical territorial units to define four categories of designated areas: underdeveloped areas; declining industrial areas; rural areas; and areas of high unemployment. The coverage, which totalled 33.4 percent in 1998, is reviewed each year (at least with respect to the industrial restructuring areas) and is subject to a ceiling of one-third of the national population.

**Table 11: Designated areas in Hungary - 1998**

| **Area type** | **Population coverage (%)** | **Designation indicators** |
|---|---|---|
| Underdeveloped | 29.6 | Development level less than 75% of national average (based on complex mix of demographic, economic and infrastructure factors) |
| Declining industrial | 2.8 | Higher than average industrial employment<br>Higher than average unemployment<br>Unfavourable ratio of industrial employment compared with 1990 situation |
| Rural | 12.9 | Change in agricultural employment<br>Migration balance<br>Change in per capita personal income |
| High unemployment | 17.1 | Rate of permanent unemployment (> 6 months) more than 1.25 times the national average |
| Total | 33.4 | |

Note: There is some overlap between categories of designated areas.

Elsewhere, the designation process is less sophisticated. In the Czech Republic districts are designated as ‘affected by structural changes’ (industrial regions with traditional industry and high unemployment) and as ‘economically weak regions’

(regions with lower standards of living, mostly rural areas). As in Hungary, the list of designated regions is reviewed each year given the dynamism of regional change in CEE. A similar approach has been used in Poland to define the unemployment problems areas for special labour market policy support.

In Slovenia, indicators of migration, the rate of population growth and age structure of the population are used to designate 'demographically endangered areas' which currently cover around one-quarter of the population (and 55 percent of the land area of the country). Under the draft legislation of the Promotion of Regional Development, three new types of designated area have been proposed:

- *underdeveloped regions* - of two types (a) regions with per capita income tax less than 75 percent of the national average, and (b) border areas with negative demographic trends eg. negative population indices over the 1981-91 period;

- *industrial problem areas* - based on indicators of industrial structure, industrial decline and high unemployment, and

- *other problem areas* - national parks and other areas with limited development potential.

### 2.6 Summary and conclusions

Against a background of generally positive national economic indicators and trends, regional disparities are growing in CEE with a fragmentation of regional economies. Divisions between cores and peripheries, between urban and rural areas, and between the western and eastern parts of CEE countries are increasing. The major agglomerations and urban centres are leading the transformation process, in particular the capital cities which dominate in terms of new firm formation, SME activity, employment creation, foreign investment and tourism. Intra-urban disparities are also growing with a restratification of social groups caused by the privatisation of housing markets. Many rural areas are not sharing in the benefits of transition, instead experiencing rising unemployment, falling employment opportunities and outmigration. Whereas the western border areas are exploiting their proximity to EU countries through new economic opportunities, the eastern peripheries are heavily disadvantaged, characterised by poor infrastructure and unfavourable economic structures. In all countries, the old-industrial areas present major challenges of restructuring, diversification and environmental regeneration, with rising unemployment threatening social stability.

The policy response to regional disparities has been slow to emerge, reflecting the priority given to political reforms and macro-economic stability. Until recently, institutional arrangements for regional policy were non-existent or ad hoc with no central government responsibility for regional development, a lack of intermediate regional or district administrative units capable of exercising economic development functions, and a highly fragmented map of municipalities. Over the past few years, the situation has changed with the nomination of government ministries to take charge of regional policy and the creation of formal inter-ministerial co-ordination mechanisms to bring sectoral ministries together. Specific agencies and centres have been established to support the design and implementation of regional policy, and an increasingly dense network of sub-national regional development bodies is emerging.

The objectives of regional policy are rarely specific, encompassing a mix of efficiency and equity goals, combining the introduction of market economy and self-sustaining growth in all regions with the reduction of regional disparities in employment, income and infrastructure. Specifically ‘regional’ policy instruments are difficult to define but most countries operate two types of instrument: regional development programmes, provided to municipalities or agencies for economic development purposes; and regional aid schemes, awarded directly to enterprises, usually SMEs, and universally in the form of loans, guarantees, interest-rate subsidies and tax incentives rather than grants. Expenditure on regional policy, insofar as comparable data have been obtained, indicate that spending may range from 8 MECU to 82 MECU. Lastly, area designation systems are progressively being introduced. Most use unemployment as the main criterion but more sophisticated systems are emerging, notably in Hungary.

This review of regional development in five of the CEE countries underscores the dynamism of both regional disparities and regional policies with rapid changes in regional economic conditions, institutional infrastructure and policy responses. In concluding this comparative assessment, several observations are worth highlighting.

First, regional disparities are likely to increase and intensify. The rates of GDP growth vary significantly between the leading regions (capital cities) and remaining regions; the annual increase in GDP per capita of Prague, for example, is twice that of other Czech regions. Projections of GDP growth over the next five years suggest a widening of regional disparities by up to 50 percent. This polarisation of development is already causing problems in terms of stagnation in rural or peripheral areas as well as congestion and labour shortages in the capitals. Whether this continues depends significantly on greater regional differentiation of economic development, particularly in potential ‘growth poles’ such as secondary cities and small and medium-sized towns. However, these are medium and long-term challenges: a more pressing issue are the regional problems associated with old-industrial regions where the need to create alternative employment opportunities is critical.

Second, in developing regional policies, CEE countries generally do not have a choice between equity and efficiency objectives. Some commentators (eg. Molle 1998) have suggested that CEE policymakers need to make a strategic choice as to what level of resources will be allocated to the effort to improve national economic growth and efficiency versus the effort to increase equality issues and the requirements of disadvantaged social and regional groups. In the long term this is certainly true. In the short- to medium-term, it is likely to be false dichotomy. As outlined earlier, regional policymakers face the twin challenges of securing a market economy in every region while dealing with severe regional/local problems. The sub-national institutional infrastructure is still largely inadequate for many economic development functions, and regions are heavily reliant on central government intervention and administration in most aspects of regional and local development.

Third, the ability to deal with the above challenges depends on resolving the question of an 'intermediate tier' of governance. With weak municipalities, the creation of a regional tier is an urgent issue in most countries to enable the decentralisation of government administration, whether through deconcentration to the State offices of central government or devolution to regional authorities. Initial experiments, for example in Hungary, have also demonstrated the potential for regional agencies/authorities to take the lead in strategic economic development tasks, bringing together municipalities and various regional, local and sectoral interest groups to identify common priorities and resources for regional action.

Fourth, the role of the EU is regarded as contentious. In providing structural policy assistance to CEE countries, the EU has effectively heightened the profile and political priority of regional policy; arguably some of the recent progress made in establishing regional policy institutions, legislation and instruments would not have taken place so speedily without the prospect of EU resources. Under the Phare programme (and through bilateral technical assistance), the EU has made a significant contribution to the launch of pilot programmes and projects as well as capacity building, training, and advice in the regional policy field. More questionable is the EU's insistence on transition countries complying with the principles of the Structural Funds, notably programming and partnership, in order to qualify for EU structural support. Several CEE regional policymakers argue that the EU approach to programming and partnership is not necessarily compatible with the current regional development situation and policy priorities of the CEE countries.

Finally, the exchange of experience in the field of regional policy between Western and Eastern Europe has been characterised by misunderstanding. Analysis of regional policy in CEE has not always recognised the CEE differences between countries. Each of the CEE countries has its own political, economic and socio-cultural history, in particular its legacy from the socialist era. Most have had their boundaries reshaped more than once this century, a fact which continues to exert a powerful influence on the spatial dynamics of economic development. They have also adopted distinctive approaches to transformation ranging from gradualist change to so-called shock therapy. Combined with differences in geopolitical situation, political leadership, systems of governance, entrepreneurial traditions and infrastructure endowments, these factors increasingly inhibit generalisation about the paths of national and regional development among CEE countries. As noted earlier, the CEE states also have their own intellectual and policy traditions in the regional development field that predate liberalisation and reform, although implemented primarily through sectoral planning in a radically different economic environment. At the same time, Western European regional policies - which themselves are undergoing shifts in thinking, organisation and policy practice - have only partial relevance for the CEE countries. In short, a more sophisticated approach to understanding the evolving paradigm of regional development in the transition economies is required.

# 3. REGIONAL INEQUALITY AND POLICY IN THE CZECH REPUBLIC

## 3.1 Reform and transition: the context for regional development

With an area of 76,866 square kilometres the Czech Republic is one of the smaller European countries with common borders with Germany, Austria, the Slovak Republic and Poland. It is a member of CEFTA (Central European Free Trade Agreement), an associate member of the EU, and a member of the OECD. In terms of population at 10,3 million, it is similar in size to Austria, Belgium and Hungary.

Over the past eight years, the Czech Republic has experienced problems common to other CEE countries, mainly as a legacy of central planning, most notably: very limited private ownership of land, over-dependency on trading with the socialist bloc, and limited contact with the outside world before 1989. Further disruption was caused by the division of the former Czechoslovak Federal Republic on January 1 1993 into two independent republics, the Czech Republic and Slovakia.

Reforms began shortly after the fall of communism in 1989, prioritising: price and trade liberalisation, withdrawal of subsidies to enterprises, internal currency convertibility and restrictive monetary policy, institutional changes, and a rapid privatisation. As elsewhere, general trends have involved a sharp downward trend in economic indicators over the 1989-92 period with recovery beginning again in 1993. Sectoral changes have involved fast growth in the service sector, a decline in manufacturing and mining, and stagnation in agriculture and construction. The highest growth rates were attained in 1995 but declined again in 1996, showing very little improvement in 1997 and 1998. In the second quarter of 1998, GDP fell by 2.4 percent year on year, after a decline of 0.9 percent in the first quarter (Financial Times, 1998c). The Czech Finance Minister predicted that economic growth would recover to between 2 and 2.5 percent in 1998 before accelerating to four percent in 1999 (Financial Times 1997a). However, the OECD predicted economic growth of only 0.9 percent in 1998, although the Czech Statistical Office was more optimsitc with an estimation of 1.4 percent (Financial Times 1998a).

The process of privatisation is advanced with the private sector generating almost 80 percent of total GDP in 1997. The Czech government has pursued three major programmes of privatisation: property restitution, small scale privatisation and large scale privatisation (Turnovec, 1997). Voucher privatisation (part of large-scale privatisation) has been the hallmark of Czech economic transition, based on the distribution of vouchers to every citizen who registered for them. Although this form of privatisation had its downside - it has left existing managers in charge of firms, dispersing the ownership of privatised companies among scores of investment funds - by the end of 1996 only a few important firms, such as the railways, post and national airlines remained fully state owned.

**Table 12: Economic summary**

| Indicator | 1997 |
|---|---|
| GDP (CZK billions) | 1,650 |
| Estimated level of real GDP (1989=100) | 98 |
| GDP per capita ($) | 5,050 |
| Inflation rate (annual ) | 10.0 |
| Share of industry in GDP | 35.0 |
| Unemployment rate (% ) | 5.2 |
| Current account / GDP (%) | -6.1 |
| Trade balance (USD billion) | -4.6 |
| *Exchange rate £1=57 koruna (end 1999)* | |

Source: EBRD, 1998

## 3.2 Regional disparities and problems

There are considerable difficulties associated with the comparability of demographic, labour market and GDP statistics in all the acceding countries, and the Czech Republic is no exception. This is related to problems of data collection, definitional issues and the differing stages of development of individual countries.

The Czech Republic experienced a natural population decrease in the period up to 1995; the latest population projection for the Czech Republic forecasts a decline in the birth rate and an increase in death rates as a result of an ageing population. These developments, coupled with a net increase in migration, may mean that the population in rural areas will decrease more rapidly than in towns, leaving some areas depopulated. There are also differences in population trends between regions. Between 1991-1995, the Czech Republic experienced a net natural decrease of 23,338 which mainly affected the capital city - Prague (20,083) and Mid-Bohemia (12,503). Positive natural increases occurred in North-Moravia and North-Bohemia. The working age population (15-59) accounted for 64.6 percent of the total population in 1997 (Andrle, 1997). According to the latest prediction from the Czech Central Statistical Office, the 15-59 age group will fall to 65.3 percent in 2000, while the over 60 age group will increase to 18.4 percent (from 18.0 in 1997). The population is ageing as life expectancy increases, though it is still far behind that in West European countries (Turnovec, 1996). The Czech Republic was the subject of medium- and short-term migration from other CEE countries. In terms of internal migration, the biggest recipient of migration flows was Prague. Until 1992 the population of Prague grew steadily, but since then it has decreased (from 1,212 thousand in 1992 to 1,205 thousand in 1996) due to natural population decline.

In the labour market, first Czechoslovakia and then the Czech Republic have been highly interventionist (Nunnenkamp, 1997). After 1989, the Czech government’s approach to the labour market combined a restrictive unemployment benefit system with active employment measures (Burda, 1993). It meant relatively low unit labour costs, encouraged more labour-intensive production and led to the increased international competitiveness of Czech industry. The proportion of economically active people (those aged 15 years and over) in the Czech Republic has initially been very high, but has been declining steadily (Czech Statistical Office, 1996).[3]

A major sectoral *employment* shift from agriculture and industry to the service sector has taken place (Tucker, *et al* 1997). Agricultural employment has fallen in the Czech Republic from 13.2 percent in 1989 to 5.9 percent in 1996. The same is true for secondary sector employment declining from 46. 5 percent in 1991 to 40.6 percent in 1996. Service sector employment has increased in terms of both its share of total employment (from 46.6 percent in 1992 to 51 percent in 1995) and in absolute numbers (Statisticka rocena, 1996). The highest decreases in the employment rate were experienced by North-West Bohemia, Northern Moravia regions and the Kladno district.

At the start of the transition process, a rise in *unemployment*[4] was not only considered inevitable, but was also taken as an indicator of the extent to which reforms in most policy areas were progressing (Boeri, 1997). However, the Czech Republic was a remarkable exception with an unemployment rate no higher than six percent. It is puzzling since even Slovakia, which shared the same history of institutional and political development, experienced unemployment rates similar to those in other CEE countries (Burda, 1995). Unemployment, peaked at 4.4 percent in early 1992, then fell to 2.5 percent in late 1992 where it remained until the end of 1996 rising to 5.6 percent by 1998 (Tucker, *et al*, 1997). A further reason for low unemployment figures in the initial stages of transformation was the Czech service sector's capacity to absorb workers made redundant in the industrial sector. As the incentives for workers to register as unemployed were limited, it helped to maintain the low unemployment rate. Czech unemployment also has a cultural and ethnic dimension, since many unemployed are Romanies. Skilled manual workers still have no problem finding work but people without qualifications, who form three quarters of the unemployed, still have difficulty finding employment (CEBD, 1998). In pre-1989 Czechoslovakia, there was an excessive concentration of industry in Northern Bohemia and Northern Moravia. Consequently, in 1996, these two regions had the highest unemployment rates.

After some improvement between 1994-95, the regional disparities in unemployment have increased in 1997. The districts with high unemployment were: Most (12.4 percent), Chomutov (12.1), Louny, Teplice and Karvina (10 percent).There are also a number of micro-regions (within districts) which experienced high unemployment rates. The problems of industrialised regions are further compounded by their apparent difficulty in creating new employment opportunities and/or attracting new private businesses. The link between high unemployment and long-term unemployment poses a further threat to industralised regions with consistently high unemployment levels.

There are methodological problems with calculating GDP at the national level, and it is very difficult to provide reliable and comparable GDP statistics for the early 1990's. According to one recent source, the decline in Czech GDP was overstated by a third,

[3] It should be noted that there are problems with the comparability of employment data. The census of population and employment surveys classify data by residence, while current labour statistics use job location.

[4] Labour offices recorded the number of unemployed from 1990 (unemployed are defined as the number of applicants for work). As well as Labour Offices, the Czech Statistical Office provides quarterly sample surveys.

due to a failure to record the impact of the unofficial economy (Vintrová, 1994). The first official GDP statistics at a regional level for the period 1993-1995 were published by the Czech Statistical Office in 1998 and are expressed in CZK, ECU and PPS in order to provide a basis for comparison with EU statistics.

In 1991, the Czech economy suffered a decline in GDP which continued for two years, followed by gradual recovery between 1994 and 1996. In 1997 the Czech GDP rate of growth was down to one percent. Between 1991 and 1996), GDP per capita (as expressed in USD) and its growth painted a similar picture, although it is obscured by the fact that the nominal dollar exchange rate did not fluctuate while Czech inflation climbed steadily over this period of time (Turnovec, 1996).

In economic terms, Prague is the only region where GDP per capita is higher than the national average. The disparity between Prague and the rest of the country has increased recently and the remaining regions have GDP per capita lower than the national average. Inter-regional disparities (apart from Prague) are relatively low (Andrle, 1998).

Looking back across the period from 1990 onwards, there have been five kinds of problem regions in the Czech Republic (OECD, 1996): regions with restructuring problems, regions with high unemployment, backward/peripheral regions (which suffered from lower than average standard of living) and border regions, along the German and Austrian borders. Virtually the entire Republic fell into one of these categories. Since then, reforms and system of subsidies have altered regional development patterns. Between 1992 and 1997 the following regional trends can be observed:

- a significant drop in the production and employment in heavy industries (mainly in old industrial regions such as Northern Moravia, and North-West Bohemia);
- a reduction in the number of employees in agriculture in some districts of Western, Southern and Eastern Bohemia and Southern Moravia;
- a high concentration of tertiary sector employment in big cities and towns; and
- low inter-regional mobility of workforce due to the restricted availability of private and public provision of housing.

## 3.3 Administrative/institutional structures for regional development

### *3.3.1 Territorial administrative structures*

Before 1989, the administrative system in Czechoslovakia comprised five levels: a federal government, two republic governments, ten large administrative regions (or *kraj*) plus Prague and Bratislava, 114 districts (*okres),* and over 7,500 municipal governments. The system of regions and districts which existed in 1989 dated from 1960. Currently there are 77 districts and over 6,000 municipalities. The common feature of Central European regions is their small size, and the Czech Republic is no exception (Surazka, 1996). Among the 77 Czech districts, 29 have fewer than 100,000 inhabitants. Self-government and elected authorities only exist at the communal level.

The districts are regarded as 'functional regions' and may continue to exist after the year 2000. Their offices have, at the moment, special departments for regional development which are coordinated by the Ministry for Regional Development. The 1960 law which established nine regions was still in force until 1990. Nevetherless, there are some deconcentrated administrative authorities in sectors such as environment and agriculture. Following the new law on local government, passed on 3 December 1997, 14 new administrative regions will be established from 1 January 2000 (see map). The creation of new regions and the preparation of laws on districts and municipalities remains the responsibility of the Ministry of the Interior, although it needs to cooperate closely with the Ministry for Regional Development, the Ministry of Finance (which will prepare budgets for the existing and proposed administrative regions) and observe the principle of subsidiarity.

There is currently a lack of elected administrative units between the levels of State and the communes, although the Czech constitution foresees their establishment in the future. Current discussions regarding the new administrative regions concentrate on several issues:

- the need to deconcentate and devolve some of the central government's functions to the new regions and districts;
- to what extent self-governmental tasks should be performed at regional level and how to increase the role of the representatives of municipal councils at the meso-level which is governed from the State offices;
- how to improve the relationship with over 6,000 municipalities and the administrative centre; and
- how the new higher self-governing bodies should perform their administrative functions and how to implement the principle of social partnership.

So far, the Velvet Revolution has led to regional fragmentation rather than consolidation since it removed the larger units *kraj*. (Surazka 1996). There is a strong feeling among the Czech policy makers that the new administrative reform will remedy this problem. Table 13 illustrates the main features of the new regions.

**Table 13: Division of the Czech Republic into new regions.**

| Name | Population ('000) | No. of districts | No. of municipalities | Area |
|---|---|---|---|---|
| Prazsky | 1,210 | | 1 | 496 |
| Stredocesky | 1,107 | 12 | 1,147 | 11,014 |
| Budejovicky | 626 | 7 | 623 | 10,056 |
| Plzensky | 555 | 7 | 505 | 7,560 |
| Karlovarsky | 305 | 3 | 131 | 3,315 |
| Ustecky | 825 | 7 | 352 | 5,335 |
| Liberecky | 429 | 4 | 216 | 3,163 |
| Kralovehradecky | 554 | 5 | 448 | 4,757 |
| Pardubicky | 510 | 4 | 451 | 4,519 |
| Jihlavsky | 523 | 5 | 730 | 6,925 |
| Brnensky | 1,141 | 7 | 643 | 7,067 |
| Zlinsky | 601 | 4 | 297 | 3,965 |
| Olomoucky | 646 | 5 | 392 | 5,139 |
| Ostravsky | 1,289 | 6 | 297 | 6,871 |
| **CR** | **10,321** | **76** | **6,233** | **78,866** |

Source: Constitutional Act on establishing Higher Self-government Regional Units (Czech Parliament, 23.10.1997)

### *3.3.2 Regional development institutions*

As elsewhere, central government has overall responsibility for the development and implementation of regional policy, and proposing the budget allocation for regional policy for ratification by Parliament. Initially, from 1992 onwards, the ministerial responsibility for regional development, was vested in the Ministry of Economy. In 1996 the *Ministry for Regional Development* was established as the principal administrative body to regional policy; its creation has improved coordination between the activities of various sectoral ministries. The Ministry is responsible for matters concerning regional policies (including development of rural areas and revival of villages). It performs several tasks, including: area designation; the management of financial allocations for regional policy purposes; co-ordination of the activities of the central state authorities with regard to regional policy design and implementation; and overseeing the preparation of regional development policies and strategies including those co-financed by the European Union. Other responsibilities include regional programmes to support SMEs, tourism, housing policy, urban planning and construction regulations. Harmonisation of sectoral policies and an improvement in regional planning are also the responsibility of the Ministry.

Providing specific support for the Ministry is the *Centre for Regional Development in the Czech Republic*. The centre originated in the National Information Centre and was established earlier than the Ministry for Regional Development. The main task of the centre is to initiate the development of economic activities in the regions through its direct and indirect support, particularly in the area of information services. As the centre functions as an operational arm of the Ministry for Regional Development it has established a system of regional branch offices. Through the EURO INFO Centre it organises the exchange of information about SME activities in the Czech Republic and EU.

A number of other central administrative authorities are involved in the regional policy sphere, in co-operation with the Ministry for Regional Development, where their budgetary or thematic competencies are relevant to the implementation of regional policy. Their tasks include: contributing to the goals of regional policy in line with the relevant programmes; preparing regional plans in conjunction with the Ministry for Regional Development; and responding to the needs of different regions where appropriate. One important implementation body is *The Bohemian-Moravian Guarantee and Development Bank* which operates the main instruments of assistance - especially financial support for SMEs.

At the central level there are 14 ministries and 8 so-called administrative bodies (such as the Statistical Office, the Czech National Bank, etc.). The Government Committee for European Integration is the central coordinating body for EU accession related matters. Each of the sectoral ministries in the Czech Republic has at least one programme which has regional implications. Of particular note are the following.

- *The Ministry of Agriculture* is responsible for developments in agriculture, revival of villages, regional programmes of support to SMEs, tourism, housing policy, urban planning and construction regulations. Several institutions controlled by the Ministry are important for the development of rural areas: the State Fund of Market Deregulation which was created to allow flexible balancing of supply and demand of agricultural products; the Property Fund which administers state-owned property through a network of offices at district level; and the Support and Guarantee Agricultural and Forestry Fund which focuses on providing guarantees for risk loans and reducing interest rates.

- *The Ministry of Industry and Trade* is responsible for industrial policies (including SMEs), economic policy, power supply, construction and mining. Its two agencies (Czech Invest and Czech Trade) play an important role from the regional development point of view.

- *The Ministry of Finance* is the central body in the State administration responsible for internal controls over the State budget, taxes, fees, customs duties and foreign exchange. It operates through a network of territorial financial bodies. Its *Equalisation Grant* aimed at municipal authorities has an important regional impact and is bigger than funds for regional development.

- *The Ministry of the Interior*, responsible for public administration, is currently involved in the preparation and implementation of detailed administrative reform.

### *3.3.3 Regional/local authorities and agencies*

The Czech Republic consists of 76 districts (*okres*) (plus Prague) and 6,196 rural and urban municipalities. *The municipalities* are the basic self-administrative entities and perform functions of state administration at the local level on the basis of delegated powers, albeit to a limited degree. The Czech Republic is characterised by a substantial dispersion of population, reflected in a large number of small municipalities, especially in Central, Southern and Eastern Bohemia. The municipalities manage their internal affairs independently; current relationships between the State and the municipalities can be described as based on cooperation and partnership. State administrative functions are performed primarily by *district offices* whose scope of activity is determined by government decrees.

Substantial changes will take place from 1 January 2000 following agreement in December 1997 to establish higher self-administrative territorial units (see map). The Czech Republic will then be divided into municipalities as the basic self-administrative units, and regions, which are the higher self-administrative territorial units.

At a regional level Regional Development Agencies (RDAs) play an important role. They are the responsibility of the Ministry for Regional Development, but their day-to-day activities are coordinated by the Centre for Regional Development. One of the main objectives of development agencies is the preparation of a regional development strategy within the national strategy, based on the analysis of regional and external conditions. There are 13 RDAs functioning in the Czech Republic and new ones are being established. In most cases they are the result of a bottom-up initiative and operate with Phare support.

As a rule, the Czech government has no share in RDAs and each of them has a different system of financing. For example, RDAs in Most and Liberec were created through an initiative by regional actors (mines and banks). In contrast, an RDA in North Moravia and Silesia was established as a result of top-down initiative. Their finances are a mixture of various sources (30 percent state, 30 percent local businesses and 30 percent association of towns and municipalities). With financial support from the Phare programme, the RDAs produce brochures about their regions and information for foreign investors. With support from the ECOS/OUVERTURE programme and with the participation of foreign partners from Frederiksborg (Denmark), Lorraine (France), Shannon (Ireland) and North-Rhine Westphalia (Germany) the North Moravian and Silesian RDA is involved in the so-called REGVIS 2005 economic development project to develop the North Moravian and Silesian region up to 2005.

## 3.4 Regional policy

### *3.4.1 Evolution of regional policy*

Before 1989, Czechoslovakia's regional policy focused on creating functionally separate regional economies. The authorities designated certain regions for the development of chosen industries. It created the administrative units (*kraje)* in order to support this industrial policy (OECD, 1996). At the beginning of the transition period, there was confusion over the nature of regional policy. Debate about reform policies and their impact was not limited to the Federal and Republic governments. The federal government, the republic governments and municipal ones had different perceptions of regional problems. At the end, the responsibility for regional policy was vested in the respective Republic governments. Following transformation, the main objectives of regional economic policy were approved by the government on 30 December 1992 and outlined in its ‘Principles of Regional Economic Policy’. This document outlined two priorities for regional policy: regions with high unemployment; and regions undergoing major restructuring. The targeted regions comprised 16 out of 73 districts and 42 percent of the population. They aimed to enhance the development of so-called ‘problem areas’, mainly through direct support for entrepreneurial activities and infrastructure development. Over the years, regional development has been enhanced by a series of programmes for the promotion of small and medium-sized enterprises.

Between 1992 and 1996, a Deputy Minister within the Ministry of Economy was made responsible for regional development. However, the Ministry of Economy lacked sufficient resources and political support for this new office. Since mid-1996, a more pro-active approach to regional development has been adopted. The creation of the Ministry for Regional Development, with its remit to lead regional policy and improve inter-ministerial co-ordination, may help to clarify roles.

At present, regional development initiatives are implemented through sectoral policies at a national level. Financial assistance is directed to weak regions which are selected principally on the basis of unemployment rates. In 1996, the selected areas covered 18.4 percent of the population of the Czech Republic.

Currently, debate surrounds the specific objectives of regional policy. These mainly concern the degree to which institutional responsibility should be further devolved/deconcentrated in the Czech Republic. Amongst other issues, the extent of devolved responsibilities for policy and budgetary controls, and decentralisation of political power need to be addressed. Major conceptual problems are associated with the establishment of regional boundaries (and regional identity) in terms of economic and political functions. The primary concern is likely to be the way in which the reformed economic and administrative organisations will coordinate their actions and functions. Questions may arise concerning inter-departmental responsibility and the linkages to regional authorities.

### *3.4.2 Policy instruments*

Within the framework of regional policy the Czech government has not applied such traditional instruments as tax relief and investment grants. Complicating the matter further is the fact that the current taxation system does not acknowledge the existence of different rates and conditions for growth in the regions. Nevertheless, there is a wide variety of policy instruments through which the objectives of regional policy in the Czech Republic are pursued, focusing on modernisation and competitiveness. The main incentives available are:

- state guarantees for bank loans;
- full or partial reimbursement of the interest paid on bank loans;
- grant subsidies or loans; and

- the provision of bonuses for job creation.

These policy instruments can be utilised for a wide range of activities, notably: direct or indirect support for business development including agriculture and tourism; transport services and infrastructure development; the provision of both civil and technical public services in the region; human resource development; environmental protection and sustainable development; and the preparation of regional programmes and the support of institutional capacity development in the region.

Regional support is closely linked to SME policy assistance, evident from the Government programme to support small entrepreneurs in 1996, comprising five programmes, two of which were of a 'basic' nature while the others could be regarded as 'additional programmes'.

- *START*: Eligible for enterprises with up to 24 employees (trade organisations with up to 10 employees), for projects which do not exceed CZK 10 million. The subsidy represents a five percent interest rate for bank credit over four years, but the total contribution should not exceed CZK 2 million. This programme may be combined with the ZÁRUKA, REGION or SPECIAL programmes.

- *ROZVOJ (Development)*: Eligible for enterprises with up to 500 employees within the REGION programme/area. The subsidy represents a three percent interest rate for bank credit over four years, but the total contribution should not exceed CZK 5 million. This programme may be combined with START.

- *REGION*: This is an additional programme to START or ROZVOJ. In order to qualify, enterprises must be located in problem areas and with fewer than 500 employees. The subsidy represents a four percent interest rate over four years, and the total contribution should not exceed CZK 3 million.

- *SPECIAL*: This is an additional programme to the START, ROZVOJ, ZÁRUKA programmes for enterprises with up to 500 employees, which employ handicapped people. The subsidy equals CZK 1,000 each month over a period of four years (paid annually in arrears). The total amount paid should not exceed CZK 3 million.

- *ZÁRUKA*: This programme is designed for enterprises with up to 500 employees, and allows them to obtain cheaper bank credit It may be combined with the START, ROZVOJ and SPECIAL programmes.

Programmes for support to SMEs (with up to 250 employees). are administered by the Ministry of Trade and the Ministry for Regional Development. Applications are made through the Bohemian-Moravian Guarantee and Development Bank. The following programmes can be viewed as 'regional development' support programmes::

- *REGION:* Programme of loans for investment projects in districts affected by stuctural change (Decin Chomutov, Karvina, Kladno, Most, Ostrava and Teplice) and economically weak regions (Bruntal, Breclav, Cesky Krumlov, Jesenik, Klatovy, Louny, Prachatice, Svitavy, Tachov, Trebic and Znojmo).(see map)

- *VILLAGE*: Programme of support for the creation and development of SMEs in municipalities with up to 2000 inhabitants.

- *PREFERENCE:* Programme of loans to small businesses in areas undergoing structural change.

- *REGENERATION*: Support for businesses in heritage reserves, zones and sites registered in the Central Register of Cultural Heritage Objects.

- *SPECIAL:* programme of support for SMEs which create employment for citizens from disadvantaged and problematic social groups.

### *3.4.3 Designated problems regions*

There are a number of qualifying conditions for the application of regional support in the Czech Republic. These include:

1. Regions that qualify for state support under the following headings:

- regions undergoing structural adjustment - former industrial regions where traditional industry is declining and there is a high unemployment rate; and

- economically weak regions - mostly rural regions with a weak economic base and a lower standard of living.

2. Other regions designated by the government including:

- border regions supported within the framework of the Phare programme

- rural areas within the framework of the rural restoration programme

- former military territories, Ralsko and Mladá.

- some micro-regions with particularly high unemployment rates.

Since 1993 the most effective measure for improvement of less developed districts and areas affected by the process of restructuring was based on support to SMEs. The REGION programme (described in section 4.3) provided more favourable conditions for SMEs situated in these districts. The list of problem regions is updated annually. In 1998, assisted areas covering 22 percent of the population and 18 of the 77 districts were designation (see map) and included:

- Districts affected by structural changes: Most, Karvina, Kladno, Teplice, Chomutov, Decin, Ostrava and Prerov. Some of the districts are in the North-Bohemian administrative region, and others in North-Moravia.

- Economically weak regions: Jesenik, Tachov, Znojmo, Louny, Cesky Krumlov, Prachatice, Bruntal, Trebic, Breclav and Klatovy (Vymezeni region ).

In May 1999, under increasing internal and external pressure, the Czech government approved a special regional aid package for North-West Bohemia. Support is being provided for business infrastructure and tourism development, and a similar programme is under preparation for the Ostravsko region.

After accession to the European Union, the government of the Czech Republic and the European Commission will agree on the support framework for selected regions through the European Structural Funds. This support will be implemented on the basis of Regional Operational Programmes or through Single Programming Documents. In the meantime, allocation under the Phare programmes fulfils the role of pre-accession funds.The Phare allocation for the Czech Republic totalled 32 MECU in 1997 and 27 MECU in 1998.

**Table 14: Phare allocation**

| **Sub-Programmes/Projects** | **Allocation (MECU)** |
|---|---|
| Strengthening the democratic System, the Rule of Law, Human Rights and the protection of Minorities | 2.0 |
| Economic and Social Cohesion | 7.0 |
| Strengthening the Insitutional/administrative capacity to implement the Acquis | 3.0 |
| Agriculture | 3.0 |
| Justice and Home Affairs | 4.8 |
| Environment | 2.15 |
| Management | 0.5 |
| EU programmes including TEMPUS | 4.55 |
| Total (National Phare programme 1998) | 27 |

Source: Country Operational Programme 1998 (Financing Memorandum). Issued by the Centre for Foreign Assistance, Ministry of Finance of the Czech Republic.

The above table clearly indicates that expenditure on Economic and Social Cohesion (Preparation for Structural Policies) represents the highest proportion of overall expenditure. Table 14 illustrates the main priorities within this category.

**Table 15: Economic and Social Cohesion (Preparation for Structural Funds)**

| Sub-project | Institution Building | Investment | Total Phare | Recipient | TOTAL |
|---|---|---|---|---|---|
| The establishment of National Development Strategy and Support for Structural and Cohesion Funds | 2 | | 2 | | 2 |
| Training programmes | 1 | | 1 | | 1 |
| Preparation for Participation in ISPA and SAPARD | 1 | | 1 | | 1 |
| Investment Support for Micro-region projects | | 3 | 3 | 0.8 | 3.8 |
| TOTAL | 4 | 3 | 7 | 0.8 | 7.8 |

Source: As table 3.

As Table 14 illustrates, institution building is the highest priority and consequently attracts the highest proportion of funds within the Economic and Social Cohesion category.

Phare financial assistance from 2000 onwards will comprise aid for agriculture and a structural instrument similar to the Cohesion Fund. The Phare programme is the main financial instrument for the pre-accession strategy in the Czech Republic and, from 1998, has concentrated principally on:

- Institution building, absorbing 30 percent of available funds will be implemented through training, technical assistance and twinning of institutions in the Czech Republic and Member States.

- Investment support in three key areas: agricultural restructuring, regional development and human resources.

The Phare programme is very important for regional policy in the Czech Republic as it ties in the economy with EU regional policy and programmes. Furthermore, it plays an important part in achieving the aims the Association Agreement related to regional policy. Regional advisory and information centres are formed and supported by this programme.

### 3.5 Summary

At the beginning of the transition period in what was then Czechoslovakia, there was some confusion over the nature of regional policy. Since 1993, the Czech Republic has developed its own approach for dealing with regional problems. Initially, government assistance was directed mainly towards individual firms rather than regions. The current debate is manly concerned with the degree to which institutional responsibility should be further devolved.

There is a wide variety of policy instruments through which the objectives of regional policy are pursued. Their main aim is to promote modernisation and competitiveness. They focus on problem regions and have become a core element of the governments' efforts to combat unemployment. Further efforts to assist problem regions can be found in foreign donor organisations' support, mainly in Phare programmes. They extend financing to small and medium sized enterprises in regions in economic difficulty.

# 4. REGIONAL DEVELOPMENT IN ESTONIA

## 4.1 Reform and transition: the context for regional development

Although many structural problems were inherited from the Soviet period, Estonia's progress towards economic and political independence began from a position of being one of the most advanced republics of the former USSR with a relatively well-developed infrastructure, a skilled workforce and a relatively mature industrial base. The structural transformation of the economy during the post-1945 period, when Estonia changed from a predominantly agricultural economy to one dominated by heavy industry, was associated with a significant increase in trade and production links with the USSR and large inflows of labour, particularly in the eastern counties of Estonia.

An economic reform programme was initiated during the perestroika period through a Law on Economic Autonomy, passed by the Supreme Soviet in 1989. Initially this had little impact upon economic restructuring and the actual functioning of the economy as Moscow still retained control over foreign trade, industry and monetary policy. Nevertheless there was growing debate regarding the direction of economic development during this initial phase - economic dependence on Soviet markets should be re-oriented towards western European markets and the centrally planned economic structure should be replaced by a free-market based on private property. Various economic reforms were initiated during the early stages of transformation such as price liberalisation, wage determination, privatisation, currency reform and a review of the banking sector. The basic emphasis of economic reform has changed little since its inception - minimal state intervention, an open competitive economy and a liberal economic policy.

Like other transition countries, Estonia suffered a massive collapse in output in the early 1990s with year-on-year negative GDP growth ranging between -8 and -14 percent for four years from 1990 to 1993. The decline was halted in 1994 with a resumption of growth in 1995 and projections of GDP growth of up to 10 percent for 1997. Estonia's economic transformation during the first two years of independence, reflected many of the deep rooted structural problems from the Soviet period. The development of a new institutional and economic infrastructure, the creation of a separate monetary system, new regulatory agencies and new development strategies had to contend not only with the problems of the old economy but with difficulties encountered in the restructuring process itself. Estonia's initial difficulties in the reform process were largely a consequence of two major shocks. First, the dissolution of the Former Soviet Union (FSU) caused significant disruptions in trade and previous payment and financial arrangements. Second, a substantial deterioration in terms of trade with the FSU was created largely as a consequence of Russia's rapid move to world market prices for energy exports to the Baltic States.

In addition to these problems, and as a consequence of the enormous inflationary rise in the Soviet rouble, Estonia had little scope for implementing gradualist policies. Any delay in the reform process would not only have caused a continuing downturn in output but would also have created greater political resistance towards market-oriented reforms.

The reform process can be broadly divided into two separate phases. The first period involved the rapid development of a private sector; the stabilisation of inflation; the reform and development of institutional structures; and the rationalisation of economic incentives. In the second phase, during the second half of 1993, structural reforms were deepened and measures to improve the privatisation process were initiated in conjunction with the removal of barriers to discontinue non-viable state enterprises. State budgets were considerably reduced through the removal of subsidies and concessionary credits.

The initiation of sovereign monetary and exchange rate policies evolved from the formation of both a strong and independent central bank and the early introduction of a separate currency. The development of these policies encouraged greater fiscal stability and promoted foreign trade and investment, and allowed Estonia to insulate the economy from inflationary tendencies from abroad and in particular from the worst effects of the inflated Soviet rouble. Although still high in comparison to other industrial countries inflation dropped from a peak of 1075.9 percent during 1992 to a relatively low level of 11.2 percent in 1997, (see Table 8). In order to prevent inflationary deficit financing, tighter controls over fiscal policies were introduced. Income policy measures were also introduced to arrest the potentially damaging effects of inflation and to curtail possible pressures for excessive wage increases.

Price liberalisation began in 1989 and was almost entirely complete by 1992, apart from remaining controls in areas such as land and forestry resources, oil shale reserves, medicines and various public services. Other services such as rents and public transport are controlled at the municipal level. In addition to these sectors, administrative price regulations are also implemented for companies operating with a monopoly. These are particularly evident in the sectors of power supply, water and sewerage services.

Following the significantly restrictive trade regime inherited from the Soviet period, Estonia embarked upon a radical restructuring of trading relationships. All tariff and non-tariff barriers to imports and exports were quickly abolished. Although Estonia is currently considering initiating protective measures for a variety of agricultural products (largely as a consequence of deep-rooted structural problems within agriculture) the current trade regime is very liberal. International trade agreements have been secured: since June 1992, observer status in both GATT and the World Trade Organisation (full membership of the WTO is currently being reviewed); a free trade agreement with the EU and EFTA countries; and application for membership to the Central European Free Trade Agreement (CEFTA). A number of other bilateral agreements exist such as the free trade agreements with both Latvia and Lithuania and more recently the signing of the Baltic-American Charter on 16 January 1998.

Reforms to foreign investment and privatisation were one of the more significant early changes, especially important for reorienting trading networks with the West and attracting foreign investment to revitalise both industry and commerce. Historically, Estonia developed from a relatively distinct capitalist/entrepreneurial past. The Estonian Soviet Socialist Republic (ESSR) had been the ‘testing ground’ for market experimentation by the Soviet Union. During perestroika in the late 1980s, private enterprises (mainly agricultural co-operatives) were allowed while a later law on the formation of joint-stock companies during 1990 led to the registration of almost 10,000 private enterprises. Although the growth in new private enterprises was important in stimulating economic growth, it was the privatisation of previously state-owned enterprises which helped to revitalise the economy.

Small-scale privatisation in Estonia was initiated during the period of Soviet *perestroika.* Large-scale privatisation did not begin until 1991, relatively late compared with other transition economies. All small and medium-scale privatisation is complete and, by the end of 1996, nearly all large former state enterprises had been sold. Virtually all of the industrial and service sector has been privatised, putting well over 70 percent of the economy in private ownership. The remaining enterprises are in the transport, telecommunications and energy sectors; several firms including Estonian Railways, Gesti Energia (the State energy company) and Eesti Polevkivi (major oil shale producer) are presently preparing for privatisation. Bankruptcy legislation was passed in 1992 with a significant number of procedures being implemented particularly within the agricultural sector. The utilisation of the Bankruptcy Law to transfer assets into private ownership has become increasingly common.

Foreign investment began during 1987-88 under the Soviet Union's early reform programme, with intensified efforts during the early period of reform. In August 1991, a year after independence, over 2,500 foreign firms had been registered. The introduction of the kroon in 1992 benefited foreign investors by insulating foreign firms from the inflationary effects of the rouble. (Although not formalised until 1994, the kroon has always been fully convertible for current account transactions. The Central Bank has always guaranteed conversion of hard currency and reserve deposits, and has no power to devalue the currency.) By 1994 foreign investment had doubled and by 1997 had risen to 3.2 billion kroons. International comparisons with other countries in Central and Eastern Europe illustrate that Estonia is in second place to Hungary in terms of FDI per head (Maclean, 1997). While the majority of FDI has come from Finland and Sweden, other European countries (Denmark, UK, Germany, Austria), North America and East Asia have recently become more important investors. In 1996, 25 percent of all investment came from the USA.

The reform of the banking sector was another vital component of the early transition process. The post-independence period in Estonia provided the opportunity for Estonian banks to start modelling themselves on a Western-style banking system. The aggressive diversification of the Estonian banking sector into stock-broking insurance, leasing and asset management, and borrowing abroad (at largely favourable rates) has created an increasingly strengthened system. This was further reinforced by a period of rationalisation and consolidation during 1992, and the later adoption of new banking laws and legal support systems as well as the harmonisation of Estonia and EU banking regulations.

**Table 16: Economic Summary, 1997-98**

| Indicator | 1997 |
|---|---|
| GDP (kroons millions) | 65,080 |
| Estimated level of real GDP (1989=100) | 73 |
| GDP per capita ($) | 3,230 |
| Inflation rate (annual ) | 12.0 |
| Share of industry in GDP | 19.4 |
| Unemployment rate (% ) | 10.5 |
| Current account / GDP (%) | -12.0 |
| Trade balance (USD billion) | -1.1 |
| *Exchange rate £1=25 kroons (end 1999)* | |

Source: EBRD, 1998

## 4.2 Regional disparities and problems

The former Soviet period, prior to the initial period of transition, had a significant impact upon the development of regions in Estonia. From a market-oriented perspective the development priorities of the Soviet period were no longer relevant, and the consequences of the transition from a centrally planned economy to a market oriented economy created a situation where regional disparities became significantly amplified largely as a result of the restructuring process rather than any significant imbalance in the centrally planned economic structure. Inevitably, the transition from centrally-planned economy to market economy, has reshaped the development potential and competitiveness of regions. Some regions suffer from the consequences of the changing emphasis and priorities of the market economy. Typical examples include centres formerly reliant on now-abolished collective farms and military bases, notably in the regions of Ida-Viru in the north-east and Võru in the south-east.

### *4.2.1 Patterns, trends and factors*

Several distinct *demographic* changes have accompanied the transformation to a market economy. The population of Estonia, 1.566 million in 1989, fell to 1.462 million by 1997, a reduction of over 11 percent. A negative natural population is partly responsible - birth rates have declined, while mortality rates increased, together causing a decline of -7.5 per 1,000 inhabitants in 1995. More important is the role of emigration as a factor in the decline in total population: over the 1989-95 period 80 percent of the population decrease was a direct result of emigration. Between 1989 and 1995, the previous pattern of immigration, mainly from Russia, was substantially reversed. During this period 111,515 people emigrated with approximately 34,965 immigrants arriving, resulting in a net negative balance of 76,550. The main reasons for such extensive emigration were the withdrawal of foreign armed forces, the emigration of stateless persons and previously imported labour from other former Soviet republics, such as the Ukraine and Belorussia. The decline in population has been accompanied by a decline in the share of working population. This is particularly due to the high share of working-age population amongst emigrants and, to a lesser extent, as a result of a rise in the death rate amongst the working population. In the period 1990-94, of those who emigrated from Estonia, 62 percent were in working age group, 29 percent under working age and nine percent in retirement age.

There has also been significant change in the *internal* distribution of population between urban and rural areas. The negative balance of migration was associated with reductions mostly in the urban population and in those regions with the highest share of emigrants, such as Ida-Viru and the capital Tallinn. Internally, by the start of 1996, the previous migration trend which favoured urban areas began to shift towards rural areas. The urban population began to decrease largely as a consequence of the emigration of non-Estonians from urban areas. Indeed, of the 36 percent of the total population who are non-Estonians, 91 percent lived in urban areas.

Since the early 1990s, the net migration balance in counties with higher than average unemployment, such as Ida-Viru and Võru County has been positive while in counties with lower than average unemployment such as Harju County, the net balance has been negative. While overall migration is slowing down, population groups within the most disadvantaged areas, such as the eastern border counties, have least mobility and have little opportunity to move to areas with improved employment prospects. The opposite is found in core areas where there is a greater degree of mobility amongst population groups and a much more buoyant housing market.

In those counties with an above average share of rural communities (particularly the eastern and south-eastern border areas such as Jõgeva, Pölva and Võru) the proportion of working age residents is lower than 50 percent, with the proportion of residents of retirement age above 30 percent. In Harju, the county with the largest population (37.5 percent in 1995) had the highest percentage of working population (59.7 percent in 1995), whereas Võru, a distinctly rural and agricultural county, where the unemployment rate is high, had the lowest percentage of working population (53 percent in 1995). Such imbalances in the employment structure can largely be attributed to changes in the age structure brought about as a consequence of the closure of enterprises during the early period of transformation - in particular in those settlements associated with military bases and those largely dependent upon large-scale agricultural production. Similar imbalances are evident in the mining towns of north-eastern Estonia, in the small towns around Lake Peipsi and also in the south.

The present *employment structure* is largely the consequence of the legacy of half a century of Soviet industrial policy. The Soviet styled centrally planned economic policy placed a considerable emphasis upon large-scale industries based on both significant imports of both labour and raw materials from Russia. Furthermore, as in other former communist economies, everyone was employed by law. Following relatively rapid economic restructuring, the unemployment rate increased to a relatively modest rate of 2.1 percent of the level of 1998, a figure subject to some dispute[5].

Notwithstanding the question of measurement, there are identifiable regional differences in unemployment (see Table 17), in particular a difference between urban

---

[5] The ‘official’ unemployment ratio has been regarded by many sources as a significant underestimate (Harter and Jackson 1997) with aspects such underemployment, hidden employment and black market activity thought to hide a real employment rate of nearer 15-20 percent.

and rural regions. Areas such as Tallinn (and Harju county generally) the counties of Lääne-Viru, Pärnu, Tartu and Pärnu have lower registered unemployment rates than the eastern, south and south-eastern counties of Ida-Viru, Jõgeva, Pölva, Valga and Võru, where registered unemployment figures are consistently higher. The high figures in Ida-Viru and Valga can be explained by the concentration of former large-scale Soviet-era manufacturing industries which produced mainly for the Russian market. In these counties the restructuring of former large-scale manufacturing enterprises and the slow development of entrepreneurship are the main reasons for the higher than average unemployment figures. Levels of employment/unemployment are also a reflection of the regional variation in industrial structure. The higher than average rates in the south (Pölva, Valga and Võru) reflect higher concentrations of agricultural workers, and in the north-east (Ida-Viru, Jõgeva) reliance on traditional manufacturing industries.

**Table 17: Registered Unemployed By County***

| | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|
| Harju | 1.1 | 1.0 | 1.6 | 1.7 |
| Hiiu | 2.3 | 2.3 | 2.8 | 2.4 |
| Ida-Viru | 3.5 | 3.3 | 3.6 | 3.2 |
| Jõgeva | 2.8 | 2.6 | 3.2 | 3.4 |
| Järva | 1.9 | 2.8 | 3.4 | 2.9 |
| Lääne | 2.8 | 2.8 | 2.6 | 2.4 |
| Lääne-Viru | 1.0 | 1.6 | 1.5 | 1.4 |
| Pölva | 3.6 | 3.8 | 3.6 | 3.5 |
| Pärnu | 0.6 | 0.7 | 1.3 | 1.0 |
| Rapla | 1.9 | 2.2 | 2.5 | 2.3 |
| Saare | 2.3 | 3.0 | 3.7 | 3.1 |
| Tartu | 1.2 | 1.2 | 1.5 | 1.1 |
| Valga | 3.1 | 2.8 | 3.3 | 3.9 |
| Viljandi | 3.5 | 3.0 | 3.6 | 2.6 |
| Võru | 3.8 | 4.2 | 4.1 | 4.0 |
| AVERAGE | 1.9 | 1.8 | 2.3 | 2.1 |
| Tallinn | | | 1.6 | 1.8 |
| Narva | | | 3.6 | 2.8 |

Source: Statistical Office of Estonia, Tallinn, Estonia.

### *4.2.2 Regional problems*

As noted, the emergence of regional disparities has been influenced by current transition conditions and pre-liberalisation patterns. These include four factors in particular:

- Soviet investment for energy exploitation and the need for skilled labour resulted in concentrations of production in Tallinn and Ida-Viru;

- an over-emphasised dependence on eastern markets and raw materials resulted in some instances, in an almost complete dependence of some regions on Eastern exports;

- the economic over-reliance on the militarisation of the Estonian economy and territory; and

- an over-concentration of agricultural production in large units with a correspondingly high share of Eastern exports in agriculture.

As elsewhere, regional disparities can be characterised by both west/east and centre/periphery dichotomies. A more detailed hierarchy was presented by the 1996 UNDP Estonian Human Development Report and suggests that the country can be divided into five different types of regions:

- Tallinn the capital, with around one third of the country's population, commands by far the highest national income levels, turnover per capita, retail sales per capita, FDI and creation of enterprises;

- other large cities such as Tartu, Pärnu, and the Narva-Järva agglomeration;

- the hinterlands of major cities such as Tallinn, Tartu and Pärnu;

- smaller -sized county seats and small towns; and

- rural settlements and areas with particularly dispersed populations outwith the sphere of influence of major cities.

Since 1991, differences based on the above hierarchy have become more distinct and acute. The capital Tallinn and, to a lesser extent, the other major cities such as Tartu and Pärnu have become the main centres of economic development. These centres, and in particular Tallinn, enjoy the benefits of a rapidly developing socio-economic and institutional/administrative infrastructure. Entrepreneurship and FDI levels serve particularly to illustrate Tallinn's persistently above average position in terms of level of development. As can be seen in Table 18, during 1996 Tallinn contained 40 percent of all registered enterprises, over 50 percent of all listed enterprises, and 78 percent of all foreign owned private enterprises.

Even though the government attempted to stimulate the peripheral regions, in particular the southern counties, through the offer of various incentives, foreign investors favoured Tallinn. In March 1993, 87 percent of all foreign capital invested in Estonia was located in Tallinn and it's surrounding hinterland, reflecting both the advantageous position of Tallinn (physical infrastructure, more skilled labour market, superior transportation linkages, etc) and the relative disadvantages of the more peripheral locations in Estonia.

**Table 18: Enterprises Listed on the Enterprise Register by County, 1996. (Harju County includes Tallinn City figures too)**

| | Registered Enterprises | | Estonian Owned Private Enterprises | | Foreign Owned Private Enterprises | | Number of Registered Enterprises per 1,000 Residents |
|---|---|---|---|---|---|---|---|
| | No. (%) | | No. (%) | | No. (%) | | |
| ESTONIA | 93,167 | (100) | 54,652 | (100) | 5,857 | (100) | 63.1 |
| Harju County | 43,308 | (46) | 31,447 | (58) | 4,814 | (82) | 80.6 |
| Tallinn City | 37,169 | (40) | 28,294 | (52) | 4,543 | (78) | 87.0 |
| Tartu County | 10,44 %) | (11) | 5,681 | (10) | 307 | (5) | 68.2 |
| East Viru County | 6,288 | (7) | 3,629 | (7) | 62 | (1) | 28.2 |

Source: Statistical Office of Estonia (1996)

Tallinn and it's immediate hinterland remain in a superior position to other areas throughout Estonia for a number of reasons. In a spatial context, Tallinn's location on the Baltic sea gives a crucial advantage over some of the other large urban agglomerations such as Tartu and Pärnu. Even prior to 1991 and the reform process proper, the port of Tallinn was one of the leading Baltic ports and was the second most important dry goods port throughout the former Soviet Union after St. Petersburg. Another illustration of Tallinn's comparative advantage is it's leading position in terms of tourism, again largely a consequence of it's geographical and historical background; in 1994, 93 percent of all foreign visitors to Estonia visited Tallinn.

While important regional centres such as Tartu and Pärnu are gaining in importance, they remain significantly behind Tallinn in terms of overall development. Measures have been implemented by central government in liaison with county authorities to redress the imbalance. The Estonian Investment Agency has, for example, endeavoured to divert investment away from Tallinn and into other parts of the country. Business Promotion Centres have been recently opened in each county throughout Estonia with the aim of developing new entrepreneurs and SMEs. However, it seems unlikely that other large cities can close the gap on Tallinn as a consequence of it's comparative advantage.

## 4.3 Regional Policy

### *4.3.1 Territorial administrative structures*

Estonia is a unitary state with three administrative tiers: national ministries and state agencies; county governments; and local town and municipal authorities. Under the new 1992 Constitution, rural municipalities and towns are also considered as local administrative units. As of January 1995, these numbered 45 towns, 198 rural municipalities and 11 small town municipalities. The country is divided into 15 administrative counties (see Table 19). The chief administrators of the counties (governors) are appointed for five-year periods by the government: to represent the interests of central government in the counties; to support integrated and balanced development of the county; to co-ordinate both the various activities of other state institutions including the municipalities; and to monitor and regulate legal aspects of the activities and regulative acts of the municipalities. The county governments represent the central government at the regional level, carrying out state functions in each of the 15 counties as well as managing state property and acting in a supervisory and advisory capacity in relation to local self-governments.

**Table 19**: **Administrative/Demographic features of Estonia**

| County | Territory sq.km | Population (Jan.1st,1997) | % of total population | Administrative Units | |
|---|---|---|---|---|---|
| | | | | Cities and Towns | Municipalities |
| Harju (incl.Tallinn) | 4,333 | 542,054 | 37.1 | 6 | 19 |
| City of Tallinn | - | 420,470 | 28.8 | - | - |
| Hiiu | 1,023 | 11,898 | 0.8 | 1 | 4 |
| Ida-Viru | 3,364 | 197,777 | 13.7 | 7 | 16 |
| Jõgeva | 2,604 | 41,736 | 2.8 | 3 | 10 |
| Järva | 2,623 | 43,542 | 3.0 | 2 | 14 |
| Lääne | 2,383 | 32,092 | 2.2 | 2 | 11 |
| Lääne -Viru | 3,465 | 76,007 | 5.2 | 3 | 16 |
| Pölva | 2,165 | 36,163 | 2.5 | 2 | 13 |
| Pärnu | 4,806 | 100,053 | 6.8 | 3 | 21 |
| Rapla | 2,980 | 40,125 | 2.7 | 1 | 13 |
| Saare | 2,922 | 40,335 | 2.8 | 1 | 16 |
| Tartu | 3,089 | 152,046 | 10.4 | 3 | 19 |
| Valga | 2,047 | 39,212 | 2.7 | 3 | 11 |
| Viljandi | 3,589 | 63,296 | 4.3 | 6 | 14 |
| Võru | 2,305 | 43,912 | 3.0 | 2 | 12 |
| | 1,529 | | | | |
| TOTAL | 45,227 | 1,462,130 | 100.0 | 45 | 209 |

Municipalities vary greatly in size: the smallest has 63 inhabitants and the largest - Tallinn - has 420,000 inhabitants. One third of municipalities are defined as sparsely populated. The 1993 'Law on Local Government Organisation' established the functions, responsibilities, jurisdiction and organisational structure of the local authorities as well as their relationship with other local bodies and with national government. The governing bodies are elected directly by universal suffrage every three years. The municipalities are wholly responsible for the local administration of public services and have both budget authority and tax-raising powers. The most significant current reforms concern the restructuring of public administration through continuing decentralisation and increasing the administrative capacity of state and local governments, as well as progressive administrative-territorial reform designed to reduce the number of municipalities while improving their quality of activities. Regional Associations formed by the local councils (both city/town and municipal authorities) have the power to enter into contracts with central government bodies to fulfil public obligations and duties.

### 4.3.2 *Evolution of regional policy*

The first regional policy concept was prepared during 1990 with the central principle that each area had particular preconditions for development. The development of regional policy was initially due to social needs but embraced other objectives such as regional balance in employment, income levels, environmental and general living standards, as well as preservation of the territorial integrity of the state. During 1991, regional policy objectives shifted towards the diversification of rural economic structures. In particular, in rural areas and areas suffering from recession, policy was designed to assist local governments in creating new, sustainable production activities. Less developed areas also benefited from newly introduced income tax concessions.

By 1992, three different approaches to regional policy could be distinguished. The first approach was designed to stimulate general economic development. The second was characterised by the objective to implement regional policy mainly through the County Governments. The last, and alternative approach, which emerged from the Estonian Congress, illustrated the need for all activities outwith Tallinn to be considered as regional policy. According to this approach regions should be zoned according to their varying levels of development and regional aid should be administered by central government in accordance with the principles of spatial zoning.

The Department of Local Government and Regional Development (DLGRD) was formed in the State Chancellery, becoming an independent state agency in 1993 and transferred to the Ministry of Internal Affairs. Policy was focused more on the development of business activities with Business Development Centres emerging in the south-east and in Viru and Viljandi. Under the EU Phare programme a network of Business Advisory Services Centres was formed. The main task of the business development centres and advisory services centres was to train and advise entrepreneurs, provide business services and mediate between partners. The umbrella organisation ‘Estonia Jobs and Society’ was formed which helped to establish a number of other business development centres in the counties of Hiiu, Saare and Harju as well as Tallinn.

By the end of 1994 the Regional Policy Concept was approved by central government and evolved as the basis for further regional policy activities. Regional policy was formalised as an element of national policy and worked in conjunction with, and complementary to, other sectoral policies. The main principle underlying the policy was the sustainable development of local initiative and progress in the successful implementation of socio-economic, infrastructural and environmental development. The Estonian government formed the post of Minister without Portfolio to co-ordinate national activities of regional policy, provide development funds for counties, non-governmental business centres and support national development projects.

The main event in 1995 was the formation of the Regional Policy Council. The Council’s main task was to continue to develop regional policy principles and co-ordinate their application. Regional policy was also provided for through the regional business support systems; general business support (via county governments); support for national development programmes and settlement activities; and regional policy loans.

The present regional policy programmes were initiated in 1996. Generally the funds were used for supporting regional development programmes; business support systems; regional policy loans and the development funds of counties (strategic and territorial planning). One year later, the Ministry of Internal Affairs, the department engaged in regional development and policy issues, began to administer the regional policy measures. Funding from the state budget was used for regional development programmes, the development and support of the regional business support system, regional policy loans, the allocation of funds and advice to county governments for the organisation of regional development and county planning. The Estonian Regional Development Agency was also launched; its tasks included the technical, financial and administrative role of the state funds allocated for regional development purposes.

A further regional development programme was launched in 1998. The south-east Estonian Programme was designed for the three south-east counties of Valga, Pölva and Võru. Additional programmes were also introduced: a investment support programme relating to social-infrastructure and 'crisis' areas. Harmonisation of regional policy in accordance with the principles of EU Structural Funds also began during 1998.

### *4.3.3 Concepts and Objectives*

In 1989, the Concept of Self-Financing of Estonia laid out the principle aims of regional policy. The principal aims of national regional policy have, according to the government, been developed to ensure:

- reliable living conditions for people from all regions, including the provision of opportunity to find employment, ensure basic services and a clean environment which will not endanger health and well-being;
- optimal economic growth in all regions;
- sustainable development;
- national territorial integrity; and
- an even regional population and stable settlement development dynamics.

Four distinct, inter-related features of regional development during the early 1990s were instrumental in developing the regional policy concept in response to the increasing level of regional disparities:

- the amplification of centre/periphery disparities in terms of economic growth, unemployment, income levels, access to health care, etc, including a significantly higher rate of growth in Tallinn as a consequence of its superior international position;
- the growth in unemployment within rural areas as a consequence of the loss of farming activities and employability of workers in former collective farms;

- the growth in unemployment and related social problems in settlements of the former large Soviet military bases and large industrial conglomerations in severe need of restructuring; and

- a significant change in the geo-political situation, economic ties with Russian markets becoming very minor (especially in the eastern border regions), with the reorientation of markets towards the west.

According to the Department of Local Government and Regional Development regional policy "*is a deliberate policy, pursued by the public authorities, aimed at creating the conditions necessary for balanced socio-economic growth of all regions of the country considering both regional as well as national interests*." Specifically, the principles of the policy are as follows:

- where possible permanent subsidies are to be avoided, except in cases where regional economic incentives are implemented in order to engender structural change;

- the state government acts in a supportive context within the development and implementation of local initiative; it does not seek to supplant or cannot normally compensate for the absence of local initiatives;

- local self-reliance is to be promoted rather than relying upon budgetary allocations from central government;

- unnecessary and additional institutional and administrative structures should be avoided, and regional assistance should be based upon existing regional development programmes;

- as regional development is recognised as being strongly influenced by a wide range of factors and affected by all national sectoral and macro policies, sectoral polices should be co-ordinated within the broad objectives of regional policy; and

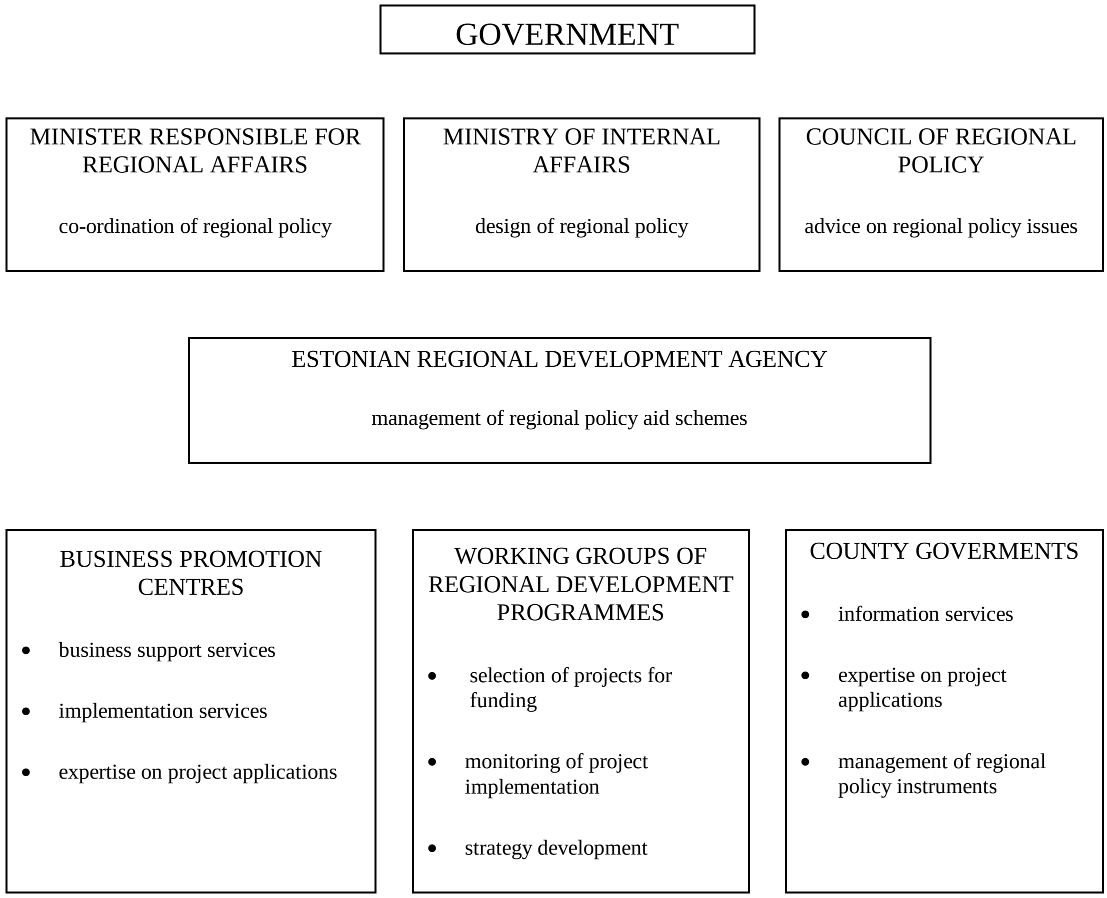
- while regional policy often targets specific areas, it is also recognised that every locality and region suffers from particular problems - the role of state government being to solve these problems and in the short-term to avoid crisis situations.

It is instructive to note that the commitment to regional policy, and particularly the development of administrative structures and financial commitment, has increased markedly since its initial conception.

### *4.3.4 Institutional responsibility*

The institutional structure of regional policy in Estonia is illustrated in Figure 4.2.1. The Ministry of Internal Affairs designs and formulates regional policy; the Ministry of Economic Affairs also involved at a national level and is particularly responsible for the development of SME policies; the Ministry of Agriculture is responsible for rural policy; and the Ministry of Environment is responsible for spatial and physical planning.

**Figure 4.2.1: Institutional structure of regional policy**




Inter-ministerial activities and duties are co-ordinated through four main mechanisms or institutions.

- *The Council of Regional Policy* has representatives of all Ministries, the County governments and local self-governments. The main responsibilities are to co-ordinate sectoral policies and advise the cabinet and different ministries on regional development issues.

- *The Estonian Regional Development Agency* (RDA) works on behalf of the four government ministries mentioned above, as well as County and local self-governments and business associations. Its main responsibilities are to manage regional policy activities and assisting other regional policy institutions with technical support.

- *County governments* are responsible for co-ordinating all regional level sectoral policy activities (business and tourism development, public services, strategic planning, etc.).

- *Inter-ministerial decision-making bodies* manage regional development programmes and loans. In some instances the decision-making bodies may also represent regional and local activities and a variety of social partners.

## 4.4 Policy Instruments

The state budget provides the funding for the implementation of national regional policy (see Table 20). Both the volume of funds and the variety of instruments have substantially increased since the early 1990s. While some of the instruments are directly funded from the state treasury, the majority of funds are allocated annually to the Estonian Regional Development Agency. Greater flexibility in co-financing has also begun.

Regional policy instruments include grants, subsidies, credits and tax reductions, all of which are administered through programmes by the Estonian Regional Development Agency (see Table 20). There are eight Regional Development Programmes which provide local authorities and NGOs with development grants. Both municipal authorities and County government must ensure that all prospective projects seeking funding meet both local and regional development priorities. Obligatory co-financing by applicants of individual projects is also an essential aspect within the process of project administration.

**Table 20: Allocation of Regional Policy Funds in 1994-98 (thous. EEK)**

| | **1994** | **1995** | **1996** | **1997** | **1998** |
|---|---|---|---|---|---|
| Development projects of national importance | 600 | 600 | - | - | - |
| Support to Lake Peipsi region | 1,000 | 1,000 | - | - | - |
| Support to small islands | 500 | 500 | - | - | - |
| Settlements programme of rural peripheries | 15,000 | 25,000 | 7,000 | 5,800 | - |
| Business support network | 1,300 | 1,780 | 5,000 | 3,900 | 9,500 |
| Development fund for County Governments | 1,500 | 3,000 | 3,000 | 4,800 | 6,000 |
| Regional development studies | - | - | - | 700 | 1,000 |
| Harmonisation of regional politics for EU accession | - | - | - | | 500 |
| Estonian Regional Development Agency | - | - | - | 600 | 1,000 |
| Peripheral Areas Programme | - | - | - | 2,200 | 9,000 |
| Islands Programme | - | - | - | 7,000 | 10,000 |
| Community Initiative Support Programme | - | - | - | 2,000 | 3,000 |
| Border Regions Support Programme | - | - | - | 3,000 | 4,000 |
| Ida-Viru Programme | - | - | - | 4,000 | 6,000 |
| Mono-functional Settlements Programme | - | - | - | 4,000 | 6,000 |
| South -East Estonia Programme | - | - | - | - | 10,000 |
| Setumaa Programme | - | - | - | 10,000 | 10,000 |
| Regional Development Loan | - | - | - | 12,000 | 15,000 |
| Local Crisis Areas Fund | - | - | - | - | 24,066 |
| Programme for Social Infrastructure | - | - | - | - | 21,367 |
| TOTAL | 19,900 | 45,730 | 40,600 | 60,000 | 136,433 |

Source: Estonian Regional Development Agency, 1998

**Table 21**: **Regional Development Programmes**

| **Programme** | **Aims/Objectives** |
|---|---|
| Programme for peripheral areas | To improve socio-physical infrastructure, to develop industry, improve the local economic base of agricultural regions and to give support to the prevention of rural de-population. The programme supports the following projects: information and community centres, tourist related, infrastructural improvement, cultural, development plans, environmental, schools. |
| Programme for mono-functional settlements | To promote access to employment where a significant proportion of the workforce are, or have been engaged in large manufacturing enterprises during restructuring period. The programme is designed to widen the economic base by promoting business enterprise development and supporting human resource management. |
| Programme for islands | To arrest out-migration through the general improvement in living conditions including the development of communications, physical infrastructure, the provision of power supply & local educational facilities. Funding from the programme has supported: reconstruction of ports, construction of harbour buildings, dredging activities, improvement of ferry services. On the smaller islands, activities include the construction of power networks, and development of schools. Applications are mainly from local governments and non-profit making organisations. |
| Programme for the Setumaa region | To promote the region in general and support the Estonian population presently living on the Russian side of the border to settle on the Estonian side. Support includes assistance for relocation grants; Setumaa Development Society; the Setumaa Association of Municipalities; the Setumaa Foundation; the Setumaa municipalities; Estonian customs and traditions in Russia. |
| Programme for south-eastern Estonia | To support a variety of development programmes within Põlva, Valga and Võru to promote a greater degree of regional autonomy through innovation, with focus on: promotion of counties; education and culture; tourism; environment; infrastructural development; business projects; and territorial planning and co-operation. |
| Programme for north-eastern Estonia (Ida Viru) | To develop new trade links & integration of immigrant population largely as a consequence of the high proportion of large-scale manufacturing enterprises with a correspondingly high percentage of Russian immigrants. A large element of the budget has been allocated to the implementation of regional development plan objectives. 16 programmes have received assistance: general county-wide development; participation at fairs; international co-operation; promotion of education; and promotion of Ida-Viru. |
| Programme for border region | To promote cross-border co-operation and international trade contacts. A large proportion of the budget is dedicated towards co-financing of regional trans-frontier co-operation projects. Projects financed include: international co-operation; tourism; youth problems; infrastructure; international co-operation and fees of international organisations. |
| Programme for rural and community development | To improve general local development through small-scale village initiatives throughout the country. The majority of funding decisions are made at a regional level. The selection of projects is carried out at County Commissions with the financial arrangements carried out by the County Governor. 65,000 kroons are allocated to each County on a bi-annual basis. |

The delivery of funding through the different programmes is allocated on the basis of geographical or administrative boundaries to various counties, or parts of counties, throughout Estonia. Table 14 provides a regional breakdown both by individual county and programme.

**Table 22**: **Allocation of Funds to Regional Programmes in 1997 (kroons)**

| County | Community Initiative Support Programme | Peripheral Areas Programme | Border Regions Support Programme | Islands Programme | Mono-functional Settlements Programme | Ida-Viru Programme | Total |
|---|---|---|---|---|---|---|---|
| Harju | 104,300 | 119,000 | - | 490,000 | 193,750 | - | 907,050 |
| Hiuu | 144,000 | 100,000 | 530,000 | 1,185,000 | - | - | 1,959,000 |
| Ida-Viru | 113,500 | 150,000 | 279,255 | - | - | 3,959,984 | 4,502,739 |
| Jogeva | 77,000 | 814,400 | 200,000 | - | - | - | 1,091,400 |
| Järva | 106,600 | 199,560 | - | - | 152,620 | - | 458,780 |
| Lääne | 141,729 | 50,000 | 500,000 | 650,000 | - | - | 1,341,729 |
| Lääne Viru | 84,000 | 297,600 | 190,000 | - | 381,000 | - | 952,600 |
| Põlva | 101,000 | 948,880 | 219,600 | - | - | - | 1,269,480 |
| Pärnu | 95,800 | 497,700 | 260,000 | 1,380,000 | 114,650 | - | 2,348,150 |
| Rapla | 160,000 | 411,600 | - | - | - | - | 571,600 |
| Saare | 156,000 | 606,600 | - | 2,380,000 | - | - | 3,142,600 |
| Tartu | 85,450 | 749,000 | 225,000 | 660,000 | 248,250 | - | 1,967,700 |
| Valga | 139,687 | 135,000 | 33,960 | - | 283,207 | - | 591,854 |
| Viljandi | 77,000 | 1,231,000 | - | - | 300,000 | - | 1,608,700 |
| Võru | 124,000 | 1,383,000 | 505,976 | - | - | - | 2,012 976 |
| Others | 265,487 | 299,960 | 14,120 | 255,000 | 471,415 | 40,000 | 1,345,982 |
| Total | 1,975,553 | 7,994,000 | 2,957,911 | 7,000,000 | 2,144,892 | 3,999,984 | 26,072,340 |
| State Budget Allocation | 2,000,000 | 8,000,000 | 3,000,000 | 7,000,000 | 4,000,000 | 4,000,000 | 28,000,000 |

**Source: Estonian regional development agency, 1998**

By 1998 the total state budget assigned for regional development programmes had increased markedly since 1994 amounting to 78,367 million kroons, including five million kroons allocated to mono-functional settlements derived from the supplementary budget to regional development programmes in 1997.

In addition to the individual programmes, a *Business Support System* has been developed within each county of Estonia mainly to support new entrepreneurs and SMEs. Licensed business consultants provide a variety of support services such as training and information on state aid schemes through County based Business Promotion Centres. The Centres also provide three aid schemes (see table 15):

- *Business Advice Subsidy Scheme*: provision of subsidies for a variety of business services. The majority of subsidies are used for the preparation of business plans, strategic analysis of the enterprise, financial analysis or market research. The budget allocation for 1998 amounted to 3.6 million kroons.

- *Regional Policy Loan Scheme*: provides flexibility in the assessment of risk in comparison to commercial banks and also provides credit for rural businesses lacking necessary collateral for commercial bank loans. Both capital for general operating costs and credit for investment are provided. The scheme aims to support mainly the service sector and small and medium sized manufacturing businesses. Decisions regarding the viability of proposal applications are made through a liaison between inter-ministerial group and Business Promotion Centres.

- *Fair Support and general assistance*: promotion of SMEs participation at national and/or regional business fairs.

**Table 23**: **Business Support System Allocations, 1997**

| County | Business Advice Subsidy (EEK) | Fair Support (EEK) | Regional Development Loan |
|---|---|---|---|
| Harju | 75,890 | | 2,000,000 |
| Hiuu | | | 2,900,000 |
| Ida-Viru | 380,508 | 22,800 | 7,850,000 |
| Jõgeva | 43,800 | 4,720 | 1,368,000 |
| Järva | 108,825 | 1,650 | 2,484,000 |
| Lääne | 111,510 | 4,720 | 750,000 |
| Lääne-Viru | 124,800 | | 2,025,000 |
| Põlva | 135,600 | 34,660 | 3,650,000 |
| Pärnu | 184,625 | | 3,765,000 |
| Rapla | 118,100 | 4,720 | 600,000 |
| Saare | 60,690 | | 10,450,000 |
| Tartu | 164,668 | 9,440 | 2,442,000 |
| Valga | 32,400 | 12,500 | 1,010,000 |
| Viljandi | 96,000 | | 4,522,000 |
| Võru | 82,650 | 9,180 | 4,250,000 |
| Total | 1,720,066 | 104,390 | 50,066,000 |

Source: Estonian Regional Development Agency - Newsletter, No.1(1), June 1998

.

Finally, a number of other instruments are employed within the Estonian regional policy.

- A development fund for various regional development activities is administered by County governments, with both public and tertiary sector activities receiving the majority of support. A special commission formed by the national government decides on the use of the development funds for local economic crisis areas;

- A policy of spatial zoning is in place for schemes covering Transport subsidies are used to support linkages between the island communities and the mainland. Funding for the regional programme for social infrastructure investment is mainly decided at County government level.

- Regionally differentiated corporate tax reductions apply to all municipalities outwith the Greater Tallinn area and seeks to stimulate investment in rural peripheral areas.

## 4.5 Summary

The regional policy approach in Estonia has evolved over the 1990s, shifting from an initial focus on social needs to the promotion of local initiative and progress in the implementation of socio-economic, infrastructural and environmental development. Regional policy is viewed as an explicit policy to create the conditions necessary for balanced growth throughout the country and current objectives include the need for policy coordination at national level and the promotion of local self-reliance. It is also recognised that, although certain areas suffer particular socio-economic difficulties, every region faces certain problems and these issues should equally be addressed by the state.

The institutional structure for regional policy is relatively well developed in Estonia. The Ministry of Internal Affairs designs and formulates regional policy and a Minister without Portfolio coordinates the national activities and provides development funds for the counties. The Council for Regional Policy also acts as a forum for the coordination of sectoral policies and inter-ministerial cooperation on regional development issues. The Estonian Regional Development Agency (RDA) was created in 1997 and works on behalf of both central government ministries and county and local governments to manage regional policy activities and provide technical support where required. A degree of decentralisation is evident with county governments responsible for the coordination of all regional level sectoral policy activities.

The budget for regional policy support has been increasing throughout the 1990s and eight regional policy programmes now operate in the country. Each programme is targeted at a type or group of regions eg. peripheral areas, mono-functional settlements, south-eastern regions and border areas, and some relate specifically to individual regions eg. the Setumaa region. The majority of funds are allocated to the Estonian RDA which distributes them to eligible counties. A variety of instruments are used by the programmes including grants, subsidies, credits and tax reductions. In addition to these programmes, other relevant support includes transport subsidies, spatially differentiated corporate tax reductions, a development fund for county government activities and the operation of a business support system for the support of new entrepreneurs and SMEs in each Estonian county.

## 5. REGIONAL DEVELOPMENT IN HUNGARY

### 5.1 Reform and transition: the context for regional development

Hungary has a longer-standing tradition of market reform, starting at the end of the 1960s, and thus was able to undergo a more gradual transition process in recent years. Nevertheless, the early 1990s were still characterised, in common with other CEE countries, by sharp declines in output and income. First signs of stabilisation were apparent in 1992, with a resumption of output growth in mid-1993 and GDP increase the following year. Difficulties arose in the 1994-95 period with the conflicting requirements of thorough banking and enterprise restructuring and the ‘reform fatigue’ of the population. The sustainability of economic growth was called into question, particularly in the face a large and increasing current account and budget deficit and the danger of a debt trap.

Since 1995, Hungary has achieved considerable economic improvement through strict fiscal and monetary policies, reinforced by large-scale privatisation, significant foreign direct investment and a 15 percent fall in real wages. The public sector deficit was cut from 9.6 percent of GDP in 1995 to around four percent in 1997 and inflation was reduced gradually to the current levels of around 16-17 percent. The stronger competitive position of the country was also reflected in the 40 percent rise in exports in the first nine months of 1997 as compared with 23 percent rise in imports. IMF estimates show that economic growth of around 4.5 percent can be expected in 1998 and an estimated 75 percent of GDP is now produced by the private sector.

FDI flows have increased with renewed confidence in the country’s economic management, following the critical debt situation in 1994-1995. Although estimates vary, it is thought that Hungary has gained $20 billion in FDI over the past seven years, the majority of which has come in the last three years. A further attraction of the country is the availability of competent Hungarian managers and skilled labour. The privatisation strategy since 1995 of cash sales to strategic investors has helped provide not only financial resources but also the inflow of new management and access to new technology and foreign markets. The banking system has been a particular beneficiary of an influx of foreign owners and managers. This has, in part, facilitated the restructuring of many former state-owned enterprises and helped establish new export-oriented industrial sectors such as vehicle assembly and components manufacture and electronics.

Criticism of the economic reform process has been levelled at the over-emphasis on attracting foreign direct investment and the lack of focus on creating an environment for the stimulation of domestic entrepreneurial activity. High corporate taxes and social charges have meant that much of this activity has been driven underground into a grey or shadow economy estimated to be contributing as much as 30 percent of national output. One of the motivations behind the pension reform undertaken by the last coalition was an attempt to remedy this by cutting the burden on legitimate enterprises and employers. The National Labour Research Centre has also estimated that as many as 1.3 million people worked in the shadow economy at the end of 1997, while the official unemployment rate was 10.4 percent at the end of that year.

Hungary has enacted a constitutional and legal framework which defines the role and powers of parliament, executive and judiciary. It has also enjoyed the benefits of a more stable government with a conservative coalition surviving for four years between 1990-94 and then superseded by a socialist/liberal coalition in the 1994 elections. In the most recent elections of May 1998, a centre-right coalition emerged comprising the Young Democrats (who gained over 40 percent of the vote in alliance with the Hungarian Democratic Forum, the dominant party in the 1990-94 government) and the Smallholders Party, a radical agrarian party. This result is partly a reflection of the economic and social pain experienced by sections of the population under the reform efforts of the previous coalition (particularly in the eastern part of the country), as well as a reaction to perceived government corruption. The principal challenges facing the new coalition include maintaining political cohesion and overcoming administrative inefficiency.

**Table 24**: **Economic summary**

| Indicator | 1997 |
|---|---|
| GDP (forints billions) | 8,446 |
| Estimated level of real GDP (1989=100) | 90 |
| GDP per capita ($) | 4,462 |
| Inflation rate (annual ) | 18.4 |
| Share of industry in GDP | 23.5[a] |
| Unemployment rate (% ) | 10.4 |
| Current account / GDP (%) | -2.2 |
| Trade balance (USD billion) | -1.7 |
| *Exchange rate £1= 406 forints (end 1999)* | |

Source: EBRD, 1998 [a]1995 figure

## 5.2 Regional disparities and problems

The analysis of regional disparities in Hungary is faced with similar data-related problems to those experience in all CEE countries. Regional statistics are most widely available at the county level (19 counties plus Budapest). As a context for the analysis of regional policy, the following section reviews a number of key regional trends and disparities which have emerged in Hungary during the 1990s. The data used is drawn from national sources unless otherwise stated.

### *5.2.1 Patterns, trends and factors*

The total *population* of Hungary is ca. 10.2 million and has remained relatively stable in recent decades. The population is homogenous from an ethnic, linguistic and historical point of view, although minority groups do exist. Concentrations of ethnic Germans live along the western border and around Budapest while the ethnic Romanian population is centred in the south-west of the country. The population density is relatively high at 110 inhabitants per $km^2$, with the highest levels found along the former industrial axis which runs from the south-west to the north-east of the country. Southern Transdanubia, in the south of Hungary, as well as the central and eastern areas of the Great Hungarian Plain are the most sparsely populated.

Over 60 percent of the Hungarian population live in urban settlements, although the structure is dominated by the capital city. Budapest has a population of nearly two million people and accounts for ca. 40 percent of the total urban population. The next most populous towns have between 100,000-200,000 inhabitants and include Debrecen, Györ, Miskolc, Pécs and Szeged. Western and northern parts of the country are characterised by a smaller village structure.

Since the early 1980s, the birth rate in the country has been falling and the ageing population represents a serious problem, particularly in rural areas. In 1996 the number of people aged over 60 was higher than those under 14 for the first time in the country´s history. These demographic trends are not expected to change dramatically over the medium-term.

In terms of the *labour market*, the rise in unemployment has been the most notable feature since the start of economic reform - although the overall rate has declined consistently since its peak in 1992. The regional pattern of unemployment shows a sharp east-west divide, with much higher unemployment in the eastern counties. The counties of Szabolcs-Szatmár-Bereg and Borsod-Abaúj-Zemplén in particular, with heavily industrialised economic structures, have shown consistently higher rates of unemployment in comparison to the remainder of the country. In 1996, for example, the unemployment rates of these two counties were 176 and 170 percent respectively of the national average (Horvath, 1998). The north-eastern region of Hungary displays the poorest overall labour market indicators. Conversely, the western Hungarian regions have relatively good unemployment indices. In 1996, Györ-Moson-Sopron and Vas had unemployment rates of 62 and 63 percent of the national average. Not unexpectedly, Budapest had the lowest rate of 46 percent of the national average.

The east-west divide is also evident in the type of unemployment. The number of unqualified unemployed workers is concentrated in the eastern counties, with Szabolcs-Szatmár-Bereg, Borsod-Abaúj-Zemplén and Jasznagykun-Szolnok accounting for 37 percent of the total (Csófalvay, Fassmann and Rohn, 1997). Overall, this spatial split of the country has remained constant throughout the period since 1990, despite changing overall levels of unemployment.

Budapest is the clear centre of the increased service sector activity which has emerged in parallel with the process of economic reform. Over 70 percent of total employment in Budapest is now in the tertiary sector and it accounts for over 35 percent of total national employment in this sector. In addition, Budapest accounts for over half of Hungary's employees in the financial and administrative services, as well as in research and development.

Finally, the regional patterns of *economic development* have changed with the process of economic reform and now also display the familiar east-west disparity. Budapest and the western regions have benefited the most from renewed economic development, both in terms of domestic growth and the inflow of foreign direct investment. Budapest is dominant in economic terms in the country as a whole. The per capita gross regional product of Budapest was 779,000 HUF in 1994; the next highest counties on the western border (Györ-Moson-Sopron, Vas and Zala) had per capita GRP of between 350,000-440,000 HUF while the three northern counties of Szabolcs-Szatmár-Bereg, Borsod-Abaúj-Zemplén and Nógrád displayed levels of less than 280,000 HUF (Csófalvay, Fassmann and Rohn, 1997). In the mid-1990s, Budapest had more joint ventures than the rest of the country combined and accounted for nearly two-thirds of all FDI flowing into the country.

### *5.2.2 Regional problems*

The dominant regional problem within Hungary is the marked east-west divide. Eastern regions, dominated by old industrial or traditional rural areas, with a small town structure, have not witnessed the same degree of economic transformation as their western counterparts. Factors favouring the development of western areas include the revitalised economic growth along the Austrian border, the relatively rapid transformation of larger towns, the tourism pull of the Lake Balaton area and the western spread effects of economic growth in Budapest. At settlement level, the pattern of economic strengths and weaknesses is more diverse, but the general east-west divide still holds true.

The other marked regional problem in Hungary is the core-periphery disparity caused by the economic and population dominance of Budapest. Table 25 summarises this situation with a number of key indicators for 1996. It is worth noting that the disparities between Budapest and the remainder of the country increased over the period 1975-95 while the differences between the rest of the counties actually diminished. This is related, in part, to the relatively even settlement hierarchy in the country, excluding the capital.

**Table 25**: **Regional disparity indices in Hungary, 1996 (national average = 100)**

| County | Unemploy-ment rate | GDP per capita | Industrial export rate | FDI |
|---|---|---|---|---|
| *Western Hungary* | | | | |
| Baranya | 111 | 77 | 55 | 76 |
| Somogy | 117 | 75 | 127 | 31 |
| Tolna | 126 | 90 | 47 | 37 |
| Zala | 85 | 93 | 79 | 37 |
| Györ-Moson-Sopron | 62 | 110 | 143 | 115 |
| Vas | 63 | 109 | 200 | 89 |
| Veszprém | 85 | 80 | 88 | 39 |
| Fejér | 83 | 102 | 149 | 130 |
| Komárom-Esztergom | 106 | 89 | 102 | 131 |
| *Eastern Hungary* | | | | |
| Bács-Kiskun | 95 | 76 | 106 | 24 |
| Csongrád | 83 | 93 | 68 | 49 |
| Békés | 16 | 76 | 101 | 65 |
| Jász-Nagykun-Szolnok | 133 | 76 | 102 | 75 |
| Hajdú-Bihar | 145 | 78 | 61 | 28 |
| Szabolcs-Szatmár-Bereg | 176 | 59 | 104 | 42 |
| Borsod-Abaúj-Zemplén | 170 | 70 | 80 | 95 |
| Heves | 119 | 73 | 68 | 70 |
| Nógrád | 151 | 57 | 89 | 87 |
| *Central Hungary* | | | | |
| Pest | 64 | 74 | 75 | 114 |
| **Budapest** | **46** | **186** | **87** | **116** |

Source: Horvath, 1998

In addition to these two major regional patterns, other specific regional problems can be identified.

- Underdeveloped and poorly resourced agricultural areas suffering from long-term depopulation and a lack of alternative economic opportunities. These areas often also contain or neighbour settlements with poor infrastructure and limited access to public services. Such areas are located in south-western and north-eastern areas as well as the so-called ‘inner periphery’ ie. the central part of the Great Plain.

- Heavy industrial and mining districts are engaged in restructuring, often with very poor environmental conditions. These problems characterise much of eastern Hungary, especially mono-company towns where the local economy has collapsed almost completely. Environmental problems are also experienced in more dynamic urban areas.

Economic growth trends over the 1990s have heightened these patterns of regional disparity in Hungary. In this context, Csófalvay, Fassmann and Rohn (1997) identify three main regional groupings and highlight economic characteristics which are likely to influence future development prospects.

- *Central and western Hungary* is characterised by good infrastructure links, dynamic private sector development, the privatisation of large state enterprises and high FDI flows. These economic conditions provide a good base for SME development and a stable labour market.

- *Southern Hungary* has comparatively poorer infrastructure connections, less effective privatisation and a smaller number of joint ventures. The development of this region will need to be driven by the private sector, exploiting the tourism potential of the Balaton region as a motor.

- *Northern and north-eastern Hungary*, with the transition to a market economy area has been dominated by large companies, both in terms of the partial privatisation of state companies and the formation of joint ventures. The Hungarian private sector is very weak, and there is a danger that these large companies could become isolated islands of economic and labour market modernisation.

## 5.3 Administrative/institutional structures for regional development

### *5.3.1 Territorial administrative structures*

Hungary is a unitary state comprising 19 counties, plus Budapest which has a similar legal status. County governments are legally responsible for services which affect the county when settlement local authorities either do not, or do not wish to, undertake them. Settlements are free to cooperate with each other in the provision of common regional tasks.

The lowest tier of the territorial administrative structure is the so-called settlement, or local authority. The local government reform act of 1990 (LXV/1990) introduced a 'one settlement, one local government' principle, which dramatically increased the number of settlements to over 3,000. Of these, 35 percent have fewer than 500 inhabitants and the average population is 3,400, which is lower than the EU equivalent. The Act increased the power of the settlement level *vis-á-vis* the counties. The principal responsibility of the settlements is the provision of basic services such as basic education, social and health services, water supply, public roads, sanitation etc. The 1996 Regional Development Act allows settlement local governments to cooperate as ‘small regions’ for economic and infrastructural development of relevance to that spatial unit. This cooperation is voluntary and takes the form of so-called regional development partnerships or associations.

The weakest level of the territorial administrative structure remains the region. The 1996 Regional Policy Act (see section 5.4.1) permitted counties to cooperate and form ‘development regions’ for economic development initiatives, to be governed by Regional Development Councils (see section 5.3.4). In the case of the Budapest agglomeration and the Lake Balaton region, the Act required the formation of RDCs because of the economic importance of these areas. For the remainder of the country, the formation of development regions and RDCs was voluntary. By 1997, six regions were in operation, covering the whole of the Hungarian territory: North-West Hungary; North-East Hungary; South Transdanubia; South Alföd; Balaton; and the Budapest agglomeration.

The voluntary and flexible nature of the current development regions makes them an insufficiently stable basis for the final designation of NUTS II regions, necessary as the territorial unit which would administer future Structural Fund resources. In 1998, the Parliamentary decision which accepted the National Regional Development Concept (see section 5.4.2) also established seven statistical planning regions. These regions will comprise the future NUTS II regions and are:

- *West Transdanubia* - Gyor-Moson-Sopron, Vas and Zala counties
- *Middle Transdanubia* - Veszprém, Fejér and Komárom-Esztergom counties
- *South Transdanubia* - Baranya, Somogy and Tolna counties
- *Middle Hungary* - Budapest and Pest counties
- *North Hungary* - Heves, Nógrád and Borsod-Abaúj-Zemplén counties
- *North-Alföld* - Jász-Nagykun-Szolnok, Hajdú-Bihar and Szabolcs-Szatmár-Bereg counties
- *South-Alföld* - Bács-Kiskun, Békés and Csongrád counties

The borders of the development regions and the statistical planning regions are broadly similar, although some discrepancies do exist. Zala county, for example, was included in the South Transdanubia development region but is incorporated with the western border regions into the West Transdanubian statistical region. The North-East region, comprising six counties, is divided into two groups of three making up the statistical regions of North Hungary and North Alföld.

### *5.3.2 Regional development institutions*

The evolution of regional policy in Hungary has been mirrored by the development of more coherent institutional structures. A key step was the agreement of the 1996 regional policy Act, part of which established more definite lines of institutional responsibility for this policy area (see Figure 5.1).

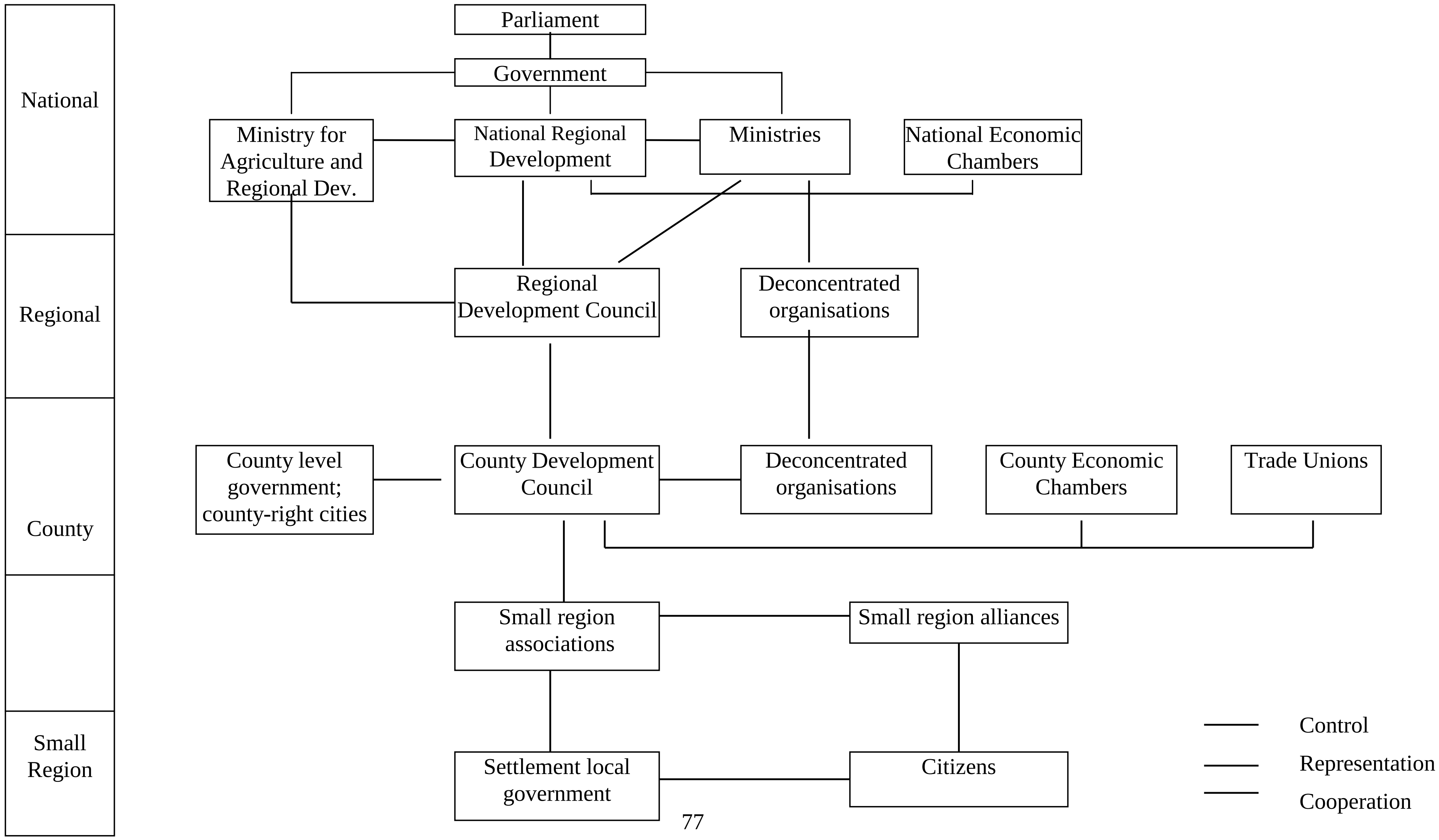
### *5.3.3 Central government*

At the highest level, the role of the Parliament was reinforced by legislation at the start of the 1990s to include regulation, financial distribution and Government supervision. In practice, the role was restricted principally to the distribution of finance. Under the regional policy Act of 1996, the tasks of the parliament were further defined to include:

- the approval of the national development strategy, principles, objectives and long-term priorities of regional policy;
- the approval of regional development and physical plans covering the country as a whole and designated priority regions and the establishment of binding elements for local governments;
- the establishment of guidelines for regional development support and designation criteria;
- the establishment of funds for regional development purposes;
- the establishment of self-government tasks in this field; and
- the demand of reports from government on development and implementation of regional policy.

In the Hungarian central government, a specific regional policy body was formed as early as 1990 with the creation of the *Ministry of Environment and Regional Policy*. Its initial position was relatively weak for a number of reasons. It had a wide range of competence but relatively few resources and conflicted directly in terms of authority with the Ministry of the Interior, which had retained responsibility for settlement planning. In addition, the lack of clear strategic direction, at least in the first half of the 1990s, made it more difficult for the Ministry to find its niche and work effectively.

**Figure 5.1: Regional Development Organisations after 1996 Act**






Source: *Regional Development in Hungary*, Ministry of Agriculture and Regional Policy, Budapest

The 1996 Regional Development Act includes the following areas as the regional and spatial development tasks of the Ministry:

- administering the implementation of regional and spatial development;
- preparing government recommendations for national regional development policy;
- preparing regional development plans and regional planning schemes for the whole country and for problem areas; and
- administering regional and spatial development tasks.

Following the elections in May 1998, a reorganisation of government Ministries moved regional policy competence to the Ministry for Agriculture. The new Ministry for Agriculture and Regional Development (MoARD) is under the jurisdiction of the smaller of the coalition parties, the Smallholders Party, which has a strong rural backing. The new Ministry will bring together all the regional policy related competencies of the government, including the formerly separate EU Integration Unit which covered the EU-funded programmes such as the Phare Regional Development Programme. The exact role and remit of the new MARP, however, is still under discussion.

In addition to the MARP, a range of other Ministries retain a degree of involvement in regional policy. This is linked to the fact that, traditionally, regional policy was subordinated to sectoral interests and this is broadly still the case. Although there are new attempts at Ministerial cooperation, little coordination exists currently in practice between the regional development activities, or other initiatives with a definite spatial impact, of individual Ministries. Government ministries with regional development related activities include:

- Ministry of Interior (settlement local government activities and regional programme management)
- Ministry of Finance (creation of instruments and regulations for regions)
- Ministry of Industry and Trade (preparation and management of regional programmes for labour force and tourism; enterprise zones)
- Ministry of Labour (employment policy, vocational training)
- Ministry of Transport, Telecommunications and Water Management (concepts for national and local infrastructure)
- Ministry of Public Welfare (health and social affairs).

The 1996 regional policy Act also created a *National Council for Regional Development*, a new body designed to assist the government in carrying out regional development. Its remit is to prepare decisions for the Hungarian parliament and government and coordinate activities in this field, particularly between national bodies and the county development councils. The Council has had significant input into the

National Concept for Regional Development (see 5.4.2) and is involved in consensus-building as regards regional development subsidies and the implementation of regional policy related resolutions. Its membership includes representatives of government Ministries, county development councils, national economic chambers, the lord mayor and national local government partnerships. Other organisations such as the Hungarian Foundation for Enterprise Promotion, the Hungarian Academy of Sciences and the Hungarian Bank for Innovation and Development participate in an advisory capacity. The president of the council is the Minister for Agriculture and Regional Development.

The National Regional Development Centre acts as the secretariat for the Council. It is responsible, at a strategic level, for regional coordination, promotion and harmonisation of national and regional development initiatives and, at the level of implementation, for the provision of technical support and help to County and Regional Development Councils. It also assists in the organisation of cross-border cooperation and initiatives in line with the Structural Fund policies of the European Union.

One interesting recent development has been the creation, within the former Ministry of Environment and Regional Policy, of an information system for regional development and physical planning (TEIR). The TEIR system, whose legal framework was established in a Government Decree in 1997, works at both national and county level, and county information systems are to be established within this framework. The TEIR is designed to collect, process, classify, evaluate and transfer regional data, broken down by region, county, statistical agglomeration and settlement. This data can be used in support of:

- organisations engaged in regional development and physical planning;
- the decision-making processes in these areas;
- impact analysis of regional development activities; and
- the preparation of regional development concepts and physical plans.

Overall, more concerted and explicit attempts are now being made to achieve greater coordination of central government structures in the regional policy field. The lack of clear strategic guidance, or strong leadership of a central institution with defined policy remit, has meant that decisions in this field have often been left to political bargaining and individual political motivation. The higher profile of regional policy, linked in part to the EU accession negotiations and prospective Structural Fund support, have helped to highlight the need for change. The coordination structures already in place are a positive development, although their operation and profile often remain relatively weak. The recent, post-election Ministerial reshuffle has obscured the direction of future progress.

### 5.3.4 *Regional/local authorities and agents*

The autonomous operation of a large number of settlements (see section 5.3), combined with the lack of power of intermediate tiers of administration, have proved a particularly difficult issue for the operation of coherent regional policy in Hungary. The voluntary nature of associations between settlements means that there is no real coherence in the formation of larger spatial planning units. Following the 1996 regional policy Act, however, some progress has been made in this area, particularly in terms of strengthening the role of the councils.

In 1996 Act established *County Development Councils* (CDCs) which are to coordinate regional development tasks within the county. Originally, two CDCs were formed within the framework of the first Phare Regional Development Programme (1993-96) for the counties of Borsod-Abaúj-Zemplén and Szabolcs-Szatmár-Bereg. The positive experience of the operation of these CDCs led to their introduction throughout the country. They comprise representatives from county assemblies and county-of-right cities, local government, economic chambers, employee interest groups and MARP and their principal tasks include:

- the coordination of development ideas from central and local government and other actors;
- evaluation of the social and economic situation of the county and proposals for long-term development concept and medium-term programmes and tasks;
- participation in decision-making regarding the allocation of local government support and separate funds; and,
- the determination of evaluation guidelines for programmes.

The CDCs are important in providing a platform for the distribution of funds at sub-national level and as a planning tier. They have increased the self-organisation capability of the municipalities and have allowed them to participate more actively in the shaping of development policy for their region. Their role in cooperating with both settlement local governments and regional administrative organisations also has the potential to increase the cohesiveness of the regional development approach in the country.

A number of difficulties still exist with regard to the operation of the CDCs (Horvath, 1998). These include the ambiguous legal status of the councils, which has led to some conflict about their role and the lack of mechanisms to ensure operational effectiveness and financial accountability. Regional development capability would be increased where the CDCs actively implement explicit regional development programmes rather than acting simply as channels for the distribution of resources. The European Commission Opinion on the Hungarian membership application also notes that cooperation both between counties and between CDCs and the national Ministries needs to be strengthened.

At regional level, *Regional Development Councils* (RDCs) have been created to govern the voluntary 'development regions' (see section 5.3). The RDCs comprise representatives from CDCs, the MARP and other relevant national Ministries, the economic chambers and local government partnerships. The principal tasks of the RDCs are specified as the drafting of regional development plans and the organisation and coordination of the economic development process within their territories. Currently, the RDCs cover the development regions but, with the creation in 1998 of statistical planning regions, the unification of these two structures with the new regional framework is planned. With the designation of the statistical planning regions, regional development plans are to be drawn up by the RDCs for each of the seven regions. It must be noted, however, that currently the RDCs are not well integrated within the territorial and regional development system and have only very limited resources and powers at their disposal.

The relative strength of the RDCs is, however, gradually improving. The State Budget Act for 1999 provides HUF 1.1 billion for the creation of regional development agencies within the seven new statistical regions, the preparation of regional development programmes and the financing of pilot projects. This represents a notable step forward in the active financing and support of regional level institutional structures and activities.

Finally, it should be noted that the situation at regional level is further confused through the emergence of a range of different agencies and organisations, all of which claim to have some input into the field of regional development. Many of these organisations comprise the deconcentrated administrative bodies of national sectoral ministries, whose number increased with the 1990 local government reform. Other organisations include non-government organisations such as foundations, development councils and micro-regional associations set up either by government departments or independently, often with international assistance. There is now some attempt to reduce the number of these organisations operating at sub-national level or to coordinate their activities with those of the CDCs and/or RDCs.

## 5.4 Regional policy

### *5.4.1 Evolution of regional policy*

Hungary has a tradition of regional planning from the early 1970s onwards, although sectoral objectives generally dominated regional concerns. In 1985, a Parliamentary Decree laid out the long-term tasks and aims of regional policy and included the notion of creating preconditions for indigenous development through restructuring and modernisation. The regional planning resources at that point were spatially concentrated although financial and institutional constraints severely limited the overall impact.

Regional policy has continued to develop since the liberalisation of the country, with the creation of the Ministry for Environment and Regional Policy in 1990 and the Regional Development Fund being among the initial tangible signs. The resolution on regional development, passed in 1993, represented the first clear definition of regional policy aims and instruments and specified its main tasks as:

- establishing the basis for internal and international coordination;

- regional crisis management and the economic reorganisation of traditionally backward and depressed areas/regions;

- the initiation and acceleration of selective infrastructure development projects, concentrating on the most backward areas/regions, with the aim of improving the overall disadvantageous infrastructure provision; and

- the reduction of disparities in the distribution and function of settlement infrastructure.

The key component absent at this stage was an explicit overall concept or strategy, and activity tended to remain reactive and *ad hoc* in nature. There was, however, increasing political agreement about the areas of overall need such as the requirement to support the reduction of disparities through public activity and expenditure, the need to reinforce the role of the counties and establish more effective cooperation between actors operating in this field.

The 1996 Act on Regional Development and Physical Planning (XXI/1996) represents the most important piece of regional development policy legislation to date and formed the legal basis for this policy area. The Act, which came into force in July 1996, was an attempt to introduce a more comprehensive regional development policy, taking European regional policy principles and charters into account. The Act is the first among the CEE countries to provide a legal framework for regional policy which is broadly in line with the structural policies of the EU. The European Commission Opinion on Hungarian membership notes that many sections of the law are structured with a view to adopting the *acquis communitaire* and that the Act forms the basis for a comprehensive regional policy.

The key objectives of the Act were specified as follows:

- to assist the development of a market economy in every region, to create the required conditions for sustained growth, and to improve economic conditions and quality of life through coordination of social, environmental and economic interests;

- to create conditions for self-sustaining development;

- to reduce adverse disparities (in terms of living, economic, cultural and infrastructural conditions) between Budapest and remainder of country, as well as between advantaged and disadvantaged regions; and

- to encourage initiatives by regional and local communities and coordinate them with national objectives.

A series of subsequent Government resolutions and decrees was agreed to ensure the implementation of the Act. These related, for example, to the regional policy responsibilities of ministers and national bodies, the coordination procedures for regional development concepts and programmes, enterprise zones and the regional information system.

The 1996 Act represented a significant advance in the regional policy field for a number of reasons. First, it took wider European experience into account and attempted to make the basic principles and directions compatible with European practice. Second, it attempted to create new organisational clarity by establishing the scope of authority and responsibilities of the parliament and government, as well as of municipality alliances, county and regional development councils and other relevant actors. Third, it incorporated the notion of partnership and decentralisation. Fourth, it had a clear economic development perspective, with an overall objective to strengthen spatial cohesion in the country, and allowed the use of market tools and regional economic regulators to achieve this aim. Lastly, it also introduced the concept of evaluation of instruments.

While considerable progress has been made in the field of regional policy in Hungary in both institutional and strategic/conceptual terms, there are a number of areas which still need to be addressed (Horvath, 1998). These range from financial issues, such as the overall lower level of spending in European comparison and the need for stronger coordination of sectoral budgets, to more directional issues such as the continued concentration of resources in north-eastern counties and the focus on infrastructure investment. The still weak regional tier and low level of decentralisation also presents problems for the implementation and planning of regional development. Institutions at this level require considerable strengthening and increased operational experience.

### *5.4.2 Concepts and objectives*

Individual pieces of legislation in the regional policy field have defined objectives in this area throughout the 1990s, albeit in a rather piecemeal manner. In addition, a range of programmes and concepts has emerged at regional level from, for example, the regional units of the economic Chamber or independent foundations. Once again, these concepts were not formulated in any coordinated fashion or within an overall conceptual framework.

The lack of overarching strategy was remedied to some degree by the adoption by Parliament, in March 1998, of the *National Regional Development Concept.* This concept is designed to determine the regional development principles, guidelines and aims which can be used to guide the government's regional development activity and act as an orientation point for other actors in this field. It should also outline the regional targets to be met in government sectoral policies and help to ensure that the division of tasks outlined in the 1996 Act is fulfilled. The specific tasks of the Concept are:

- to change the spatial structure to provide a basis and framework for effective, innovative and competitive economic activities and thus the dynamic development of the economy;

- to reduce disparities in economic and social opportunity, to assess socio-economic and infrastructure conditions at a larger regional scale and tackle the social problems of very underdeveloped regions and settlements;

- to develop programming methods, instruments and institutions capable (in regions of sufficient size) of the early identification and management of structural crisis and contributing to their solution;

- to assist in the mobilisation and exploitation of regional resources of economic development;

- to coordinate the activities of various sectors and ministries; and

- to encourage cross-border cooperation.

In recognition of budgetary restrictions and other constraining framework conditions, both medium and longer-term objectives have been specified within the Concept. The medium-term objectives cover more immediately practical initiatives in both crisis areas and regions where development is more advanced. The former include tackling crisis caused by acute social and employment-related problems and focusing restructuring intervention on focal points of economic crisis eg. areas of mining or military industry. In more developed areas, the objectives relate to the removal of institutional and technical barriers, the use of business promotion measures and the creation of industrial parks and enterprise zones. Wider aspects of regional development are recognised in the objective to formulate policy to reduce social, demographic and ethnic segregation.

The longer-term objectives are formulated more as overall goals and include:

- the alignment of the spatial structure of economic activities with the needs of sustainable development and natural/environmental potential of regions;

- the creation of equal economic, business and income-related opportunities for communities in different regions; and,

- ensuring that Hungarian regions, cities and large settlements are integrated into the wider European system and create conditions to allow the development of European regional centres in line with the advantageous geographical situation of the country.

The Concept is rather over-ambitious in its coverage and presents the development objectives as a mix of practical tasks and principles. It does, however, represent a move towards raising the political profile of regional policy and substituting regional development concerns over more traditional sectoral ones.

### *5.4.3 Policy instruments*

The *Regional Development Fund* (RDF), created in 1991, was the first post-liberalisation fund specifically for regional development issues - although another government Decree in 1991 also covered the provision more generally of state grants for regional development (including infrastructure) and job creation. The RDF was originally organised around a centralised distribution mechanism because of disputes between ministries about funding sources and target areas. Only a small proportion of central regional development programmes was decentralised.

In 1992, the RDF was re-organised and became a separate state fund with a range of aims including the promotion of economic development and job creation in backward and underdeveloped agricultural areas and areas of high unemployment, and the support of regional economic development programmes and business information systems. Ten sources of income were mentioned in the law regulating the operation of the RDF, including state subsidies from the central budget, international aid/loans and income from privatisation.

The 1993 Resolution on regional development specified further tasks for the RDF which were more in line with west European regional support foci, including:

- job creation facilitating market and technological advance;
- business services, including incubator units and innovation business parks;
- regional transport, telecommunication and energy systems;
- environmental considerations;
- social infrastructure related to creation of new jobs; and
- tourism.

The resolution also defined three types of subsidy which could be financed through the RDF: non-repayable subsidies; repayable subsidies; and interest rate subsidies, differentiated by development priority.

In the 1995 public finance reform, the previously separate government subsidies provided under the RDF (worth HUF 8 billion in 1995) were transferred into the general state budget. In 1997, two Government Decrees (80/1997 V.14 and 81/1997 V.16) detailed the conditions for the utilisation of the two main regional development specific budget lines - the *Targeted Budgetary Allocation for Regional Development* (TBARD) and the *Spatial Equalisation Financial Assistance* (SEFA).

The aims of the TBARD, as specified in the Government Decree 31/1998, are to reduce regional disparities, coordinate various sectoral grants to allow integrated regional programmes, promote and assist in the involvement of international finance and support cross-border cooperation. Assistance can be given for a range of objectives, and support is provided in a variety of forms including non-repayable grants, interest subsidies and repayable assistance. Table 26 provides an overview the objectives, types of assistance and award maxima. A number of general criteria apply including:

- an award maximum of HUF 1 million per employee for job-creating investment;

- interest subsidies can be provided up to a maximum of 50 percent of the interest on the loan in cases where the project is receiving no other public support and 30 percent where other where other support is being used; and

- the projected level of employment must be reached within six months of project completion and jobs created through the investment must be maintained for a period of five years.

The Spatial Equalisation Financial Assistance (SEFA) provides subsidies in priority areas of regional development to support investment made by settlement local governments. An important aspect of this support is its decentralised administration. The County Development Councils are responsible for decision-making on the distribution of the SFEA and, in 1997, allocated subsidies worth HUF 15 billion. Factors taken into account in the distribution of SEFA support include the characteristics and development needs of the county, the resources available to local government for investment in their area and the implementation of other relevant development objectives. Table 27 outlines the distribution of the TBARD and SEFA budgets by county in 1997.

## Table 26: Targeted Budgetary Allocation for Regional Policy - Assistance Types and Award Criteria in 1998

| Eligible Objectives | Type of Assistance | Underdeveloped areas | Declining industrial areas | Rural areas | High unemployment areas |
|---|---|---|---|---|---|
| Job-creating investment aimed at market and product change and protection of current employment levels | Non-repayable grant (% eligible costs) | 30 | 25 | 20 | 30 |
| | Repayable assistance (% eligible costs) | 50 | 40 | 30 | 50 |
| | Interest subsidy (% of interest of loan) | 30 | 30 | 20 | 30 |
| Creation of innovation centres, business incubators and industrial parks | Non-repayable grant (% eligible costs) | 40 | 40 | 30 | 30 |
| Preparation of regional and local development programmes | Non-repayable grant (% eligible costs) | 70 | 70 | 70 | 70 |
| Investment in productive infrastructure related to economic development and enterprise support | Non-repayable grant (% eligible costs) | 40 | 35 | 40 | 35 |
| | Interest subsidy (% of interest of loan) | 30 | 30 | 30 | 30 |
| Construction of gas distribution networks | % network development contribution | 20 | 15 | 20 | 15 |
| | Interest subsidy (% of interest of loan) | 30 | - | 30 | - |
| Development projects for non-agricultural land use | Non-repayable grant (% eligible costs) | 50 | 30 | 50 | 30 |
| Development projects for non-agricultural land use in the form of enterprises | Interest subsidy (% of interest of loan) | 50 | 40 | 40 | 40 |
| Investment to support rural tourism development | Interest subsidy (% of interest of loan) | 50 | 40 | 50 | 40 |
| Human infrastructure development projects involving job creation | Non-repayable grant (% eligible costs) | 40 | 30 | 25 | 30 |
| | Interest subsidy (% of interest of loan) | 50 | 50 | 50 | 50 |
| Special targeted programmes for local economic development | Repayable assistance (% eligible costs) | 40 | 30 | 30 | 40 |

Source: Government Decree 31/1998, Horvath (1998)

**Table 27: Regional Financial Resources by County (1997)**

| County | Budgetary Allocation for Regional Development (BARD) | Spatial Equalisation Financial Assistance (SEFA) | Total regional resources | RDEA per capita | SEFA per capita | Total regional resources per capita |
|---|---|---|---|---|---|---|
| | Million HUF | | | HUF | | |
| Budapest | 0.0 | 0.0 | 0.0 | 0 | 0 | 0 |
| Bács-Kiskun | 407.0 | 622.5 | 1029.5 | 755 | 1155 | 1909 |
| Baranya | 223.8 | 337.5 | 561.3 | 550 | 829 | 1378 |
| Békés | 341.6 | 525.8 | 867.4 | 853 | 1312 | 2165 |
| Borsod-Abaúj-Zemplen | 605.0 | 930.5 | 1535.5 | 815 | 1253 | 2068 |
| Csongrád | 297.1 | 440.3 | 737.4 | 700 | 1037 | 1737 |
| Fejér | 166.4 | 236.9 | 403.3 | 391 | 556 | 947 |
| Györ-Moson-Sopron | 119.4 | 158.3 | 277.7 | 281 | 372 | 653 |
| Hajdú-Bihar | 397.8 | 611.0 | 1008.8 | 726 | 1116 | 1842 |
| Heves | 186.9 | 287.4 | 474.3 | 571 | 878 | 1449 |
| Jász-Nagykun-Szolnok | 349.0 | 535.9 | 885.0 | 833 | 1279 | 2112 |
| Komárom-Esztergom | 133.5 | 166.7 | 280.2 | 365 | 536 | 901 |
| Nógrád | 237.8 | 372.6 | 610.4 | 1077 | 1687 | 2764 |
| Pest | 356.9 | 656.0 | 1012.9 | 359 | 660 | 1018 |
| Somogy | 219.6 | 335.2 | 554.8 | 655 | 999 | 1654 |
| Szabolcs-Szatmár-Bereg | 596.6 | 933.5 | 1530.1 | 1042 | 1631 | 2673 |
| Tolna | 146.5 | 217.0 | 363.5 | 591 | 876 | 1467 |
| Vas | 94.4 | 129.1 | 223.5 | 349 | 477 | 827 |
| Veszprém | 191.5 | 286.4 | 477.9 | 508 | 759 | 1267 |
| Zala | 149.1 | 217.4 | 366.5 | 498 | 726 | 1225 |
| **Total** | **5200.0** | **8000.0** | **13200.0** | **511** | **786** | **1297** |

Source: Ministry of Agriculture and Regional Development, *Regional Development in Hungary*, 1998

Over the period 1991-1994, around 80 percent of the subsidies provided by the RDF were for infrastructure support, with relatively little spent on the promotion of economic development. Since 1995, the focus has shifted more in this direction, particularly favouring job-creating investment. The proportion of assistance for job-creating investment in 1994, for example, was only 36.8 percent and this had increased in 1997 to 59.3 percent.

Tax incentives are also available in regional development areas. An amendment to the Corporate Tax Act in 1997 allows for the provision of 100 percent tax relief for ten-year investments of over HUF 3 billion in regional development areas. Other tax incentives are available in priority areas where unemployment exceeds 15 percent. In addition, major tax incentives have been available in enterprise zones since 1996.

Following the 1996 Act, the government re-examined the way in which development subsidies and funds are earmarked for regional development, including their distribution to counties and the classification of priority areas. Greater attention was paid to the coordination of other state budgets for regional development purposes. A Government Decree in 1997 (263/1997 XII.21) further addressed this issue, recognising that there was still insufficient coordination and overview of state resources and that practical issues such as application procedures and deadlines were not well harmonised. The Decree includes a matrix which identifies the relationship between all the principal state funds of the various Ministries, and requirement is made for greater coordination where an explicit connection between two funds exists.

In 1998, a total budget of ca. HUF 20 billion (ECU 84 million) was available for regional development, at least 70 percent of which will be administered through county development councils. This figure represents a three-fold increase in regional subsidies since 1994, but in terms of specific regional policy spending, the figure is still relatively low compared with EU experience. It is also worth noting that certain sectoral budgets, particularly those of the Ministry of Interior, are administered through the CDCs. While these may not be specifically for regional development purposes, their decentralised administration is strengthening the regional development infrastructure and the role of the counties.

Overall, the current regional policy thinking within Hungary emphasises the importance of coordinating sectoral budgets and ensuring that all national resources which have a spatial impact in their implementation take regional development considerations into account. Given the size and influence of other sectoral budgets, this is considered a more effective medium- to long-term approach than focusing on the raising of the regional development specific resources. There are still moves, however, to link specific regional policy spending to a percentage of GDP and bring this in line with European equivalent spending levels. There is also awareness in regional policy-making circles of the importance of issues such as creating a uniform and coordinated system of regional development resource allocation, reinforcing a decentralised system of administration and establishing a system for monitoring and evaluation.

### *5.4.4 Designated problem regions*

There is a historical tradition in Hungary of focusing ‘regional’ aid on specified areas within the country. A parliamentary decree as early as 1985 stated that the tasks and aims of regional support should initially be concentrated on the eastern counties of Borsod-Abaúj-Zemplén and Szabolcs-Szatmár. This geographical focus has been maintained despite the introduction of more sophisticated systems of designation and the later spread of coverage. In 1994, an Integrated Programme of Restructuring and Crisis Management was implemented in Borsod-Abaúj-Zemplén and, after a review of its economic position in 1996, this targeted support was continued. Additional subsidies were also put in place for Szabolcs-Szatmár-Bereg and Nógrád. Targeted subsidies to these counties were also included in the 1998 government budget under a number of budget lines.

Various systems of designation have been used since the start of the 1990s. The 1993 legislation, for example, defined four categories of area for regional development purposes:

- backward settlements defined using socio-economic criteria;
- settlements located in backward regions (based on socio-economic criteria) but not backward in themselves;

- settlements of employment zones where unemployment was at least 1.5 times higher than the national average; and

- settlements particularly requiring modernisation (ie. combining the above three elements)

The range of designation indicators used included the rate of long term unemployment, the number of active agricultural wage earners, per capita personal income tax, arable land value and a range of social and demographic indicators such as proportion of flats supplied by water pipes, number of cars and telephones per 1,000 inhabitants, and age balance. The selection of indicators was limited by the availability of data at settlement level. This new list of criteria resulted in a 75 percent increase in the number of assisted settlements and the inclusion of settlements in a wider range of counties.

From 1996, the system of designation shifted from the ranking of settlements to the assessment of counties and statistical areas, and generally moved more in line with the European Structural Fund categories of assisted area:

- small areas are considered socially and economically less developed when a complex indicator of demographic, economic and infrastructure factors shows a development level of less than 75 percent of the national average;

- for industrial restructuring areas, EU eligibility criteria were used - regions granted priority status have higher than national average industrial employment, higher unemployment and an unfavourable ratio of people employed in industry compared with the 1990 situation;

- for agricultural areas, again EU criteria were used as a base although amended where required to suit Hungarian characteristics eg. use of per capita personal income tax base rather than profitability of agriculture and the incorporation of a migration balance; and,

- small areas where the rate of permanent unemployment (more than 180 days) was 1.25 times the national average.

A Parliamentary resolution in 1997 on the principles of regional development subsidies, decentralisation and designation criteria introduced per capita GDP at county level for the first time as a regional development indicator. A new list of eligible areas was adopted in 1998 and covers 33.5 percent of the Hungarian population (see Table 28).

**Table 28: Designated Assisted Areas in 1998**

| Type of area | Number of areas | Number of eligible settlements | Population '000 |
|---|---|---|---|
| Underdeveloped | 83 | 1,650 | 3,017 |
| Declining industrial | 6 | 94 | 284 |
| Rural | 38 | 849 | 1,320 |
| High unemployment | 41 | 911 | 1,742 |
| **Total eligible areas** | **88** | **1,780** | **3,408** |

Note: a single small area can be included under more than one problem type - the number and population of eligible areas were only counted once
Source: Horvath, 1998

The registry of communities and regions designated as eligible for regional development support is adjusted annually and is declared in the form of a Government Decree. This is designed to make the system more flexible and respond to changing regional development problems. A Parliamentary Decision in 1997 (30/1997 IV.18) relating to the principles and conditions for regional development support over the period 1997-99 states that only one third of the total Hungarian population can be included within assisted areas at any given time. In light of this, the government adjusts the population included within industrial restructuring areas annually. This is undertaken on the basis of statistical indicators and the performance of the region in the previous year in terms of economic and infrastructure development and the regional unemployment trend.

The National Regional Development Concept also identifies enterprise zones for regional development purposes. A Government Decree of 1996 (189/1996 XII.17) specifies that the National Regional Development Council and the CDCs have the right to propose potential enterprise zones, although the final decision rests with the government. A pilot project in Záhony and its surrounding area was undertaken initially in 1994, and seven more enterprise zones have now been established in Barcs, Lenti and Mohács (South Transdanubia), Ózd and Salgótarján (North Hungarian region) and Békéscsaba-Gyula, Szeged-Makó and Berettyóújfalu (South Alföd region) Zemplén, Bihar. Tax incentives have been available in the zones since 1996.

### 5.5 Summary

Regional policy in Hungary is probably the most advanced of all the CEECs. The 1996 regional policy Act was a milestone in its evolution, establishing a legal base and a new institutional structure, as well as setting out the principles and objectives of the policy area. The Act strengthened the position of the former Ministry for Environment and Regional Policy (now the Ministry for Agriculture and Regional Development) and created the National Council for Regional Development to support regional policy design and implementation and inter-ministerial coordination. A National Regional Development Concept, accepted by Parliament in 1998, lays down the framework and objectives for future Hungarian regional policy. The budget specifically designated for regional development purposes has increased three-fold over the period 1994-98, and more attempts are being made to coordinate other sectoral budgets and ensure they take regional development considerations into account.

At sub-national level, County Development Councils (CDCs) were created under the 1996 Act and their position has been strengthened. They are also now responsible for the administration of one of the main regional development budgets for the support of settlement investment. Regional Development Councils have also been established in the development regions formed on a voluntary basis by the counties. Seven statistical planning regions were accepted by Parliament in 1998 and will comprise the future NUTS II regions.

Despite these positive developments, a number of problems still exist in the design and implementation of Hungarian regional policy. The coordination structures, both within national government structures and between national ministries and CDCs are still too weak. Sectoral interests are often still dominant and there remains insufficient coordination of budgets. The financial allocation for specific regional development purposes is still low in comparison to the European average and, among other ramifications, this would create problems for the co-financing of future Structural Fund intervention. An additional Structural Fund related difficulty would be the current inability of the Hungarian budgetary system to operate with multi-annual programmes. More experience is needed long-term planning and in the process of drafting, coordinating and implementing regional development plans at different administrative levels.

The further development of the regional policy field remains relatively uncertain following the post-election changes in mid-1998. The exact remit of the new Ministry for Agriculture and Regional Development and the role and standing of regional policy itself are currently under discussion within the Hungarian government. However, the profile of regional policy has increased considerably and the future accession to the European Union, and subsequent implementation of the Structural Funds, will also help to keep regional development on the political agenda.

# 6. REGIONAL DEVELOPMENT IN POLAND

## 6.1 Reform and transition: the context for regional development

From a European perspective, Poland is located where West-East and North-South corridors cross. With a population of almost 40 million, it is Central Europe's most populous state. The settlement network in Poland is often defined as polycentric concentration and - unlike Hungary or the Czech Republic - the spatial structure is not dominated by one large centre. In common with other Visegrad economies, Poland suffered a significant drop in the output of its state-owned sector, growing unemployment and inflationary pressure in the early 1990s. Its 'shock therapy' approach to macroeconomic reform accelerated the country's transition from a planned economy to a capitalist state country (Rzeczpospolita, 1998 f).

By 1992, a turning point in the progress of transition was reached: in that year most of the economic indicators started to improve, followed by a resumption of growth in real wages and the progressive decline of unemployment (Kuklinski, 1997). Enjoying its third successive year of growth, Polish GDP rose by between five and seven percent in 1995, one of the best rates in CEE, despite a high inflation rate of 21.6 percent). By 1997, Poland is estimated to have exceeded the 1989 level of GDP by 11.8 percent and growth trends remain strong with production in the manufacturing sector rising at a particularly high rate. At the end of 1997, the number of unemployed was 1.83 million (an unemployment rate of 10.5 percent). The rate of inflation showed a declining trend, although, at the end of 1998, was still high at 12.5 percent (see Table 29).

The ownership transformation process in the Polish economy started seven years ago and is still continuing. Privatisation in Poland occurred in two stages. First, the so called 'small privatisation' was implemented in trade, construction, light manufacturing and food processing industries, and services. The second stage, a far more complex and as yet unfinished undertaking, is based on the privatisation of large, state owned enterprises. At the end of 1997, the share of private enterprises reached 63.5 percent of total industrial production (93.2 percent in construction, and 94 percent in retailing). In terms of employment, the private sector employed almost 69 percent (11 million people) of the total labour force (RCSS, 1998). Ownership structure changes have been one of the main factors favourably influencing Poland's economic situation, but the main sectors of the Polish economy are still awaiting privatisation. In particular, the coal and steel industries will require fundamental restructuring prior to accession to the EU.

In post-1989 Poland a new model of dealing with social issues has evolved based on a more liberal approach to labour market problems, an increase in private sector employment, and the introduction of new systems of labour relations and negotiations. Currently, Poland is undergoing a major reform of its labour laws and social security system, with the intention of shifting some of the expenditure onto regional and local government budgets and private individuals (particularly for tourism and recreation).

**Table 29: Economic Summary in 1998**

| Indicator | 1997 |
|---|---|
| GDP (zloty billions) | 445.1 |
| Estimated level of real GDP (1989=100) | 112 |
| GDP per capita ($) | 3,521 |
| Inflation rate (annual ) | 13.2 |
| Share of industry in GDP | 27.1[a] |
| Unemployment rate (% ) | 10.5 |
| Current account / GDP (%) | -3.1 |
| Trade balance (USD billion) | -11.3 |
| *Exchange rate £1= 6.7 zloty (end 1999)* | |

Source: EBRD, 1998 [a]1996 figure

## 6.2 Regional disparities and problems

Obtaining and using comparative economic data for Poland's economy is beset by a number of problems. GDP statistics suffer from under-reporting of economic activity, especially in the private sector, often as a result of attempts to avoid tax payments. Uncertainty in determining GDP also occurs due to the existence of a large 'grey' economy. In addition, Poland has only recently, in line with other transition countries, adopted universal national accounting and statistical standards used elsewhere in the world.

### *6.2.1 Patterns, trends and factors*

Poland is one of the most populous countries in CEE with a population of 38.6 million. Among key *demographic* indicators there is currently a steady decline in the birth rate, due to the changing age structure of the population and a decrease in fertility rates.(Blotevogel and Russell, 1996). A recent upsurge in male mortality rates, especially among the middle-aged brackets (The Economist, 1995) can be attributed to the lowering of living standards, poorer nutrition, and increased stress associated with uncertainty linked to the transition process. The changes in the age structure of the Polish population create periodic tensions in the labour market. The Polish population is distributed more or less evenly across its territory with a medium density of population, equalling 123.5 inhabitants per square kilometre, with 62 percent living in towns. Massive migration from rural areas to towns stopped in the 1960s, but out-migration remains a serious impediment to development in some backward, more peripheral regions which have lost the most dynamic and well-educated young people, leaving for higher education, and then rarely returning to their native regions.

Changes in the labour market constitute one of the key elements of transformation processes in the Polish economy. In terms of *employment trends*[6], Poland is characterised by a declining and restructuring state sector and an expanding private

[6] Although the CEE economies now have regular Labour Force Surveys as well as a population census, recent data and employment statistics have to be treated with great caution when compared with earlier transition years (Employment Observatory, No.7. May 1995).

sector (Blanchard, Commander and Coricelli, 1995). The total number of jobs lost in Poland between 1989 and 1995 amounted to 2.6 million: a decrease in the number of people working was recorded in 48 out of 49 *voivodships*, (with the exception of Warsaw) over the period.

There is considerable regional variation in labour market trends. Eastern and, to some degree, central regions (Nowosadeckie, Lubelskie, Radomskie) are dominated by primary sector employment. Some western regions have relatively high rates of industrial employment (Katowickie 46 percent, Bielskie 43 percent and Walbrzyskie 42 percent). Upper Silesia has a major concentration of industry but there are also other centres of industrial activity such as Lodz and Czestochowa (GUS 1997). In 1997 the regional disparities in *unemployment* in Poland were very marked, ranging from two percent in Warsaw to 21.2 percent in the Suwalki region (World Economy Research Institute, 1998). Unemployment is highest in western and northern regions, and lowest in the south - Table 30 illustrates the voivodships (NUTS II level) with the highest and lowest unemployment rates. Overall, 1997 was a year marked by favourable trends in the Polish labour market. It was the fourth year of major reductions in the number of unemployed and an increase in the number of new jobs. However, regional differences in unemployment are not diminishing, despite the declining trend in unemployment across the country and in the majority of voivodships.

**Table 30: Voivodships with highest and lowest unemployment rates (1996).**

| **Lowest** | **Highest** |
|---|---|
| Warszawskie (4.1) | Slupskie (25.7) |
| Krakowskie (6.1) | Koszalinskie (24.7) |
| Poznanskie (6.2) | Suwalskie (24.6) |

Source: Rocznik Statystyczny Wojewodztw, 1997.

In the private sector, and especially in SMEs, the employment trends since 1990 have been very different (Roberts,1997). The vast majority of private enterprises expanded in the volume of business and employment, the SME sector providing work for many people who were made redundant by large, state-owned enterprises. In addition, Polish SMEs created jobs for young people, who would otherwise be unemployed (Polish SME Foundation, 1998). In 1996 the highest numbers of SME employees were in Warsaw (11.4 percent of total employees), Katowice (9.8 percent) and Gdansk (4.6 percent). There is no general pattern of regional dynamics for private employment in industry, though big urban centres demonstrate higher employment changes than rural areas. (Gorzelak, 1996).

The *economic structure* of Poland changed considerably between 1989 and 1997. The share of services rose from 35 to 53 percent, while that of industry and construction shrank from 52 to 39 percent. Agriculture’s contribution to GDP fell from 13 to 8 percent (Transition, 1997). The Polish economy has remained heavily biased towards a large share of total employment in industry, at the same time a specifically Polish feature has been the high proportion of total employment in agriculture (26 percent in 1997), due to the limited collectivisation of Polish farms.

Poland's GDP in 1996 amounted to $ 134.5 billion. In terms of GDP per capita (at PPS) the figure for 1997 is $ 7,000, equivalent to 37 percent of the average Western European level. The most aggregate indicator of economic development is *per capita GDP*[7] where Poland displays stark disparities, although the very large (regional) territorial units used for data collection hide the localised nature of regional problems. In 1994 GDP per capita was highest in the Warsaw voivodship ($ 8,669 PPS) and lowest in the Suwalki voivodship ($ 3,352); more generally the highest level of economic development (per capita GDP exceeding the national average) was observed in voivodships containing large urban centres. The contribution of individual voivodships to GDP creation in 1996 was also highly differentiated (GUS, op. cit.). There are nine voivodships (Katowice, Warsaw, Poznan, Gdansk, Krakow, Bydgoszcz, Szczecin, Wroclaw and Lodz) which produce half of Poland's GDP. The bottom nine voivodships (Biala Podlaska, Chelm, Lomza, Ostroleka, Przemysl, Sieradz, Skierniewice, Slups and Suwalki) produce just over five percent of the country's GDP. The share of agriculture in GDP creation is also strongly regionally differentiated, with the highest share in eastern and central parts of Poland and the lowest in the Katowice region.

With regard to *incomes*, there are disparities in income levels between the state and private sectors, with the latter paying significantly less. Overall, ten percent of Poles earn more than in 1989 , 36 percent earn more or less the same, while almost half of the society is worse off (Polityka, 1998b). However, 1997 was a year of rising personal incomes (nominal increase of 23 percent from 1996, real increase of 7.2 percent). Corporate sector wages in the eastern provinces (Biala Podlaska and Przemysl) were 73-75 percent of the average for the whole corporate-sector while the highest rate of growth was recorded in ten voivodships (Ciechanow, Nowy Sacz, Wwarsaw, Wroclaw, Tarnow, Bialystok, Poznan, Chelm, Lublin and Zielona Gora).

### *6.2.2 Regional problems*

Historically Poland has frequently changed (or has been forced to change) its boundaries. As a result, Poland became - and still is - divided into two parts: the western, better developed part, and the eastern, less economically advanced part. This division is evident in terms of key socio-economic statistics measuring economic activity or prosperity, including with respect to the dynamism of local municipalities and entrepreneurship. Analysis of the spatial characteristics of the transformation processes after 1989 confirms a west-east regional differentiation, a polarisation into leaders and problem areas and the marginalisation of some regions (Hausner, J, Kudlacz, T and Szlachta, J. 1995). Eastern Poland, which is highly dependent on agriculture, displays all the characteristics of a region lagging behind - poor infrastructure, below average GDP per capita and industrial activity located in a small number of centres.

[7] Nominal and 'real' statistics for GDP are often used. The nominal statistics take nationally-supplied figures and apply simple conversions at annualised market exchange rates. 'Real' GDP is claculated by using purchasing power parities (PPS) in converting nominal GDP rates. Critical differences are evident with regard to GDP per capita data, particularly when comparing international statistical data provided by the WIIW, Eurostat, the EIU and the World Bank.

The other key disparity is urban-rural. Major urban centres showed high growth rates and responded quickly to transformation challenges. These include main cities such as: Warsaw, Poznan, Wroclaw, Gdansk, Krakow and Szczecin which over the years attracted major foreign investors due to their skilled labour force, technological potential and well developed infrastructure. These areas constitute either a core location (Warsaw), sub-cores or growth poles and (Kuklinski,. European Space, 1997). Rural areas where state agriculture dominated for years (eg. north-west Poland) have suffered above average rates of unemployment. The north-west's present economic difficulties directly result from the collapse of state farms, which were the crucial element of the socialist economy in those regions. Due to their predominantly rural character they find it difficult to attract either foreign or domestic capital which could help rejuvenation and promote growth. Areas along the Baltic coast, the Mazurian lakes, mountains and some major cities benefit from an increased flow of tourists, while the border regions benefit from a new phenomenon of daily shopping tourists which helps to curb the Polish trade deficit.

Lastly, there are concentrated areas of industrial crisis. The old industrial regions of Upper Silesia and Walbrzych are in the process of major restructuring (coal and steel) and with a pressing need to tackle environmental problems. Unemployment rates are already high (>25 percent) with the prospect of further increases and restructuring procedures.

## 6.3 Administrative/institutional structures for regional development

### *6.3.1 Territorial administrative structures*

In comparison to other countries with similar spatial and demographic potential, Poland's territorial organisation has been highly centralised. In 1975, Poland's local governmental structure was reduced from three to two tiers and the number of voivodships increased from 17 to 49, thus providing scope for increased central government control. Though decision-making became highly centralised, the execution of policy was more devolved. In 1990, reform was undertaken as a temporary measure with the intention of breaking the hierarchical link between the voivodship (region) and the municipality (gmina). It also froze responsibilities at voivodship level until such time as local government at the higher levels of the powiat (district) and region were established. Unfortunately, the situation lasted much longer than intended and the vacuum between the gmina and voivodship level was often filled with various *ad hoc* initiatives. The voivods, as representatives of central government, often found themselves balancing between the needs and requirements of the centre and their immediate region.

The need for greater administrative decentralisation and the requirement for the introduction of a third tier and meaningful divisions of responsibility all motivated administrative reform which came into force on 1 January 1999. As a result of this reform, the following elected territorial authorities have been instituted (Kozak, 2000):

- Region (*voivodship*) – 16 regions have been created, replacing the former 49 provinces. Each region has an elected regional assembly and regional government. This government has, among other powers, full responsibility for the strategy and economic development of the region. Power at the regional level is shared with central government representatives in certain areas. In general, these 16 regions have been based on dynamically developing agglomerations, although this is not universally true and the Parliament has the right to dissolve any weaker regions considered not to be viable by the end of 2000.

- County (*powiat*) – 373 counties have been re-introduced in Poland, each governed by the country council and the county executive body. As a rule, the county provides public services which cannot effectively be provided by the municipality.

- Municipality (*gmina*) – the 2,489 municipalities have been in existence since 1990 and have full responsibility for the provision of typical public services and local development, including the drafting of a local strategy.

A range of key challenges face the operation of the new administrative structure. Financially, the newly created units are likely to have to rely heavily on state support in the immediate future until a stronger base of own income can be established. Organisationally, the new units must face the challenge of both fulfilling their duties and creating new internal structures and procedures requiring serious human resource investment. New skills and expertise will be required at sub-national levels which were not previously necessary within the more centralised system. Finally, the legal and regulatory framework for the operation of the new territorial structure, particularly in relation to regional development, remains currently inadequate.

### *6.3.2 Regional development institutions*

The need for relevant regional development policy institutions at the national and regional level began to be addressed in the early 1990s because the existing structures which had been established under the Communist system could not address the needs of a changing business and economic environment. There also was a growing recognition of the importance of a proper institutional structure for regional development.

At *central government* level, in the absence of one central institution responsible for regional development in Poland, the main responsibility in this area is shared by the Ministry of the Economy and the Minister in charge of the Government Centre for Strategic Studies. Currently a reformed Office of the Committee for European Integration assumes the strategic and coordinating role and will be responsible for the selection and application of projects eligible for EU and other funds. Within the Council of Ministers, a permanent Regional Development Committee will act as an ancillary and advisory body responsible for state regional policy. It is chaired by the Minister of the Economy and will probably incorporate voivods. Its first task is to prepare regional contracts for the new 16 voivodships (Polityka, 1998).

There are also several Ministries which perform tasks relating to regional development, including:

- Ministry of Interior (responsible for government activities and currently for administrative reform);

- Ministry of Finance (various financial instruments and more recently financial responsibility for Phare funds);

- Ministry of Economy (with a dedicated department for regional development);

- Ministry of Labour and Social Security (employment policy and training, implementation of infrastructural projects);

- Ministry of Transport (provision of national and local infrastructure especially motorway construction); and

- Ministry of Agriculture (rural renewal).

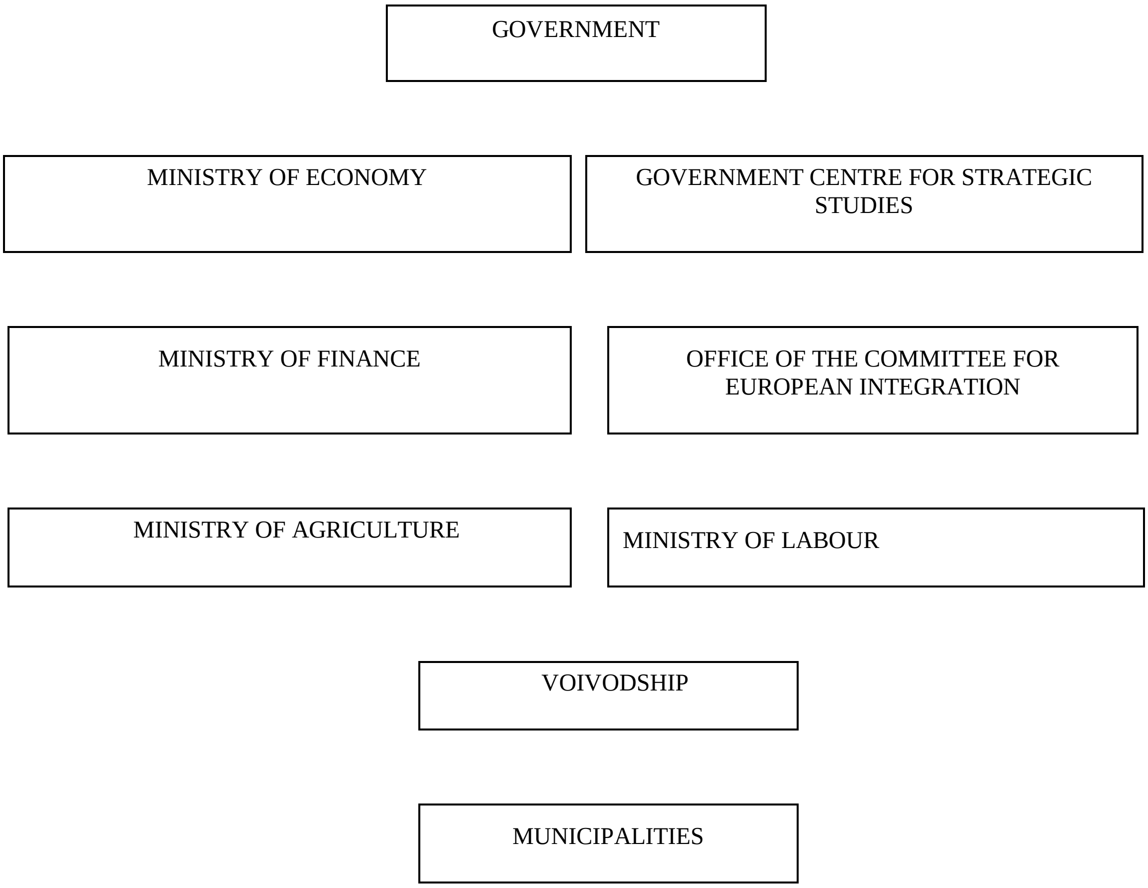
Other institutions at central and central/local levels responsible for regional development are:

- Polish Agency for Regional Development (PARR), created in 1993, which co-operates closely with agencies operating in regions covered by formal agreements and complex financial aid programmes for restructuring and growth;

- Industrial Development Agency (IDA), which is a shareholder in many regional and local agencies; and

- National Association of Regional Development Agencies (NARDA), which functions as an association and an organiser for a number of training programmes and other projects - most RDAs belong to the Association as supporting members.

**Figure 6.1: Institutional Structure for Regional Development.**




In contrast to many EU countries, and most of those aspiring to membership of the European Union, there is still no single government agency responsible for state regional policy. Links between and among regional organisations remain weak. Central and local governments are strong, but the regional (voivodship) level is under-powered.

With respect to the *regional/local level*, a self-governmental system was reintroduced in 1990 at municipality level following the first fully democratic local elections. The Polish gminas, however, remained relatively weak, relying to a great extent on funds form central government. The state financial system was also strongly centralised, with only around 15 percent of the state budget comprised of self-governmental revenues. Local taxes are very limited and local authorities have been denied the right to conduct economic activity.

There is considerable spatial differentiation of the local revenues and more importantly it reveals very interesting regional patterns. The influence of old, historical factors on the current differentiation of the financial situation of Polish gminas is very marked: almost all the poorest gminas are located in the former Russian and Austrian parts of Poland and, while the richest municipalities are scattered around the entire country, there is a greater concentration in the western part of the country. These features indicate that ‘poverty’ is much more historically grounded and therefore much more difficult to overcome

An important and distinctive feature of regional level institutions in Poland is the spontaneous creation of nearly 70 regional development agencies, distributed relatively evenly throughout the country. The majority of these organisations were set up between 1991-94. The main rationale for the creation of such agencies included the weakness of public institutions on the voivodship level, the need to search for new financial sources for economic development, and the need to fill the vacuum between public administration and the private sector. The majority operate as joint stock companies although some local development institutions were created in the form of foundations (Act on Foundations of 6 April 1994). These agencies, and the national coordinating body PARR, have become the most stable part of the institutional system in Poland and, even prior to territorial reform, were working effectively at regional level.

At local level, there are various other institutions involved in providing support to local businesses. *Chambers of Commerce* are located in every Polish region. Their activities are coordinated by the National Chamber of Commerce and they assist in establishing contacts between Polish and foreign entrepreneurs. *Centres for Innovation and Entrepreneurship***,** resulting from local initiatives, comprise business incubators, innovation and high technology centres, and centres for business support. Other institutions which contribute to regional development are *management or business schools, counselling centres and information banks*, located in 36 voivodships (mainly in Warsaw, Poznan, Wroclaw, Gdansk, and Lódz).

## 6.4 Regional policy

### *6.4.1 Evolution of regional policy*

In the post-war period, there was a centralised model of government and a planned economy in Poland. Within this framework, local and voivodship authorities were channels for the implementation of general government policies. The main paradigm of development was the Polish variant of *'uravnilovka'* (levelling out), an attempt at even distribution of economic forces/activities, smoothing out regional differences and living conditions through a system of financial transfers from richer to poorer regions.

In the 1970s and 1980s, the so-called Polish School of spatial planning was very active and well known internationally. It advocated close cooperation between theory and practice and laid the foundations of spatial planning in Poland (in the absence of regional policy/planning). In the meantime, the economic and political reality was changing due to the effects of a socialist approach to economic management which led to the ruin of some industrial giants (mainly coal mines). The then 'Solidarity' based government was forced to intervene in the Walbrzych voivodship which, in hindsight, is now regarded as a clear positive example of state intervention in regional development.

In post-1989 Poland, one of the first important economic documents, the 'Balcerowicz Plan', hardly mentions regional policy. In line with the reintroduction of a two-tier administrative system in 1990, the role of municipalities (gmina level) was strengthened. Issues of local development (and, to a certain degree, regional development) became the domain of self-government at gmina level. It could be argued that the approach to regional/structural policy adopted at the start of the transformation process in Poland was vertical rather than horizontal. It paid more attention to institutional and systemic arrangements between the local (self-governmental gmina) level and the administrative centre than to regions (voivodship level). Therefore, at the beginning of the transition period, the problems of regional development were put completely aside from mainstream economic policies in Poland. The regional aspect of economic transformation appeared only in official declarations and did not influence any significant activities of governmental agencies at national level. In fact, the government left the regional problems to market forces, letting the new economic maps of Poland be reshaped by sectoral processes.

In retrospect, the Ministry of Labour and Social Policy was the only government department conducting an explicit form of regional policy. From 1990 onwards, its policy targeted special areas of high unemployment or those affected by restructuring processes. In 1993, the Polish government with support from the Phare funds, launched a pilot regional development programme based on EU Structural Funds (Phare-STRUDER). In order to implement Phare-STRUDER and subsequent Phare funded projects, the government established the Polish Agency for Regional Development, specialising in regional/local development programmes. Two years later, the Polish government and the European Commission launched a Task Force for Regional Policy in Poland which published its findings and recommendations in a series of comprehensive reports in 1996 and 1997.

At the beginning of 1997, the Central Office of Planning was replaced by the Government Centre for Strategic Studies. The Centre is now responsible for, among other strategic duties, the preparation of the State’s spatial policy and, in 1999 prepared the Concept for Spatial Policy in Poland. However, these strategic exercises have not been translated into practice and the Government Centre has very limited influence over other departments of government. Financial resources for explicit regional policy following the strategic direction outlined by the Centre are also very limited.

A further recognition of the importance of regional policy occurred in 1998 with the formation of a newly established Department for Regional Development within the Ministry of Economy. The responsibility for regional policy now formally falls between the Ministry of Economy (short- and medium-term regional planning) and the Government Centre (longer-term regional planning). Further, as many of the activities move towards an accession driven approach, the Ministry of Finance has assumed the responsibility for financial management of Phare funds, and the Office of the Committee for European Integration has undergone major restructuring.

In conclusion, there has been no sound or comprehensive regional policy in Poland since 1989. The only regional approach to state policy arose through the prospect of political instability in the old industrial regions and in regions endangered by structural unemployment.

### *6.4.2 Concepts and objectives*

Poland's level of economic development, as measured by GDP per capita, has been far behind even the least developed EU countries (see Table 29). In terms of purchasing power parity, the figure is now 37 percent of the mean for the 15 EU Member States. It is worth remembering, that Greece, the Community's least developed country, had a GDP per capita at 56 percent of the EU mean at the time of its accession. Therefore, it is not surprising that rapid economic growth has been the priority declared by the Polish government. Also, since inter-regional disparities in Poland do not differ greatly from those occurring in EU countries, then the levelling aspect of regional policy in Poland loses its significance. Therefore, what does become more important is the support to those regions which may serve as " motors of progress". Important factors which started shaping regional policy in Poland in the mid-1990s remain closer international contacts, especially with the European Union. Pre-accession cooperation with the EU has been associated with assistance programmes, including regional ones.

The dilemmas of Polish regional development and policy are similar to those in other developed countries (CUP, 1995). First, Poland still needs to determine whether it is going to pursue the efficiency or equality model. Given the current view, that the equality postulated earlier may not be efficient or effective, the task of Polish policy makers in this area becomes even more challenging. Second, the relationship between the objectives of regional development in the EU and those of regional development in Poland need to be addressed, especially in the context of accession negotiations. Third, re-defining the link between inter and intra-regional policy, in the light of the current territorial administrative reform, becomes crucial.

From a more technical point of view, the other important problem confronting Polish regional policy was and remains its management and coordination. There is no single administrative body responsible for regional policy. Traditionally, policy has been prepared by the Central Office of Planning (which ceased to exist until the end of 1996); however, the COP did not have administrative powers to represent the government in this field. As a result, several ministries have operated their own 'regional policies' with their own budgets, programmes and regional offices.

The Polish government's programme of *Socio-economic policy for 1994-97* represented an attempt at a holistic approach to regional policy problems. Its main aims are: the creation of legal and financial conditions permitting the pursuit of regional policy at the voivodship level in line with the de-centralisation process; and channelling aid to regions overwhelmed by recession wherever the region's own potential is insufficient. The programme named the potential beneficiaries of state intervention in the area of regional development as:

- old industrial regions which require profound restructuring (Katowice, Walbrzych and Lodz voivodship);
- agricultural regions threatened by chronic recession, in which inefficient state farms predominated before (Elblag, Koszalin, Olsztyn, Slupsk and Suwalki voivodships);

- underdeveloped agricultural regions in eastern and to some extent, central Poland; and

- towns and subregions dominated by large and inefficient industrial plants (in south-eastern Poland).

More recent debate during 1999 has taken place on the concepts and direction of regional policy in Poland. At the start of the year, the draft regional policy Act developed by the Ministry of Labour was debated, criticised by opponents, among other things, for being too centralistic and lacking reference to a single central government regional policy department. In Spring 1999, a further debate on the rationale and concepts for a regional policy strategy was initiated, based on two studies commissioned by the Ministry of Economy and the Government Centre. The outcome of this debate was expected at the end of 1999. In the absence of national level strategies, regional documents have been prepared by some of the regional development agencies, several of which complied with EU standards and could be of direct use for practical development in these territories.

### *6.4.3 Policy instruments*

Financing for regional development programmes in 1998 accounted for 0.15 percent of the State budget[8]. It is also worth remembering that there is a very significant transfer of funds within sectoral policies which often have regional implications (environment, labour, mining and rural area development). They do not however, take into account regional policy criteria for the allocation and implementation of funds. Support under foreign assistance amounts to an equivalent of 0.04 percent of the State's budget. Funding for regional policy in 1995 is illustrated in Table 31.

**Table 31: Regional policy instruments in 1995-structure of funds**

| Funds for regional policy | Funds (million PLZ) | Structure (%) |
|---|---|---|
| **State budget special funds** | 129.8 | 35.3 |
| (including: funds supporting regional restructuring) | 30.0 | 8.1 |
| **EU Aid programmes** | 238.3 | 64.7 |
| (including: Phare-STRUDER) | 83.3 | 22.6 |
| **Total** | 368.1 | 100.0 |

Source: Report on Regional Policy, CUP 1996.

As early as 1990, the Polish government established basic principles for the mobilisation of central public funding in support of regional development, which are still valid.

- Funding from the centre can only increase private and local-government capital involved in project implementation and there is no question of local or regional type projects being financed entirely from the centre.

[8] Which equals to 220 million PLN (circa 65 MECU)

- Funding from the centre cannot be used to save enterprises on the brink of collapse, but should be used for co-financing initiatives leading to changes in a region's economic structure.

- Central funding in the form of grants, subsidies or shares will be given to funds, foundations, consortia and agencies in regions threatened by structural recession.

The system of instruments for the support of regional development in Poland is complex and lacks transparency, partly due to the fact that there is no ministry or agency responsible for this area. Financing is very complex and the resources which could have potentially supported regional development are dispersed which weakens their effectiveness. These resources are located across the (central) state budget, voivod's budget, public special purpose funds and public-authority agencies.

The current instruments supporting regional policy in Poland can be broadly classified as follows:

- *Financial instruments* used to lend public-sector support to the establishment and development of economic entities in the problem areas through: loans, subsidies, tax relief, allowances for the accelerated depreciation of fixed assets and subsidies related to job creation.

- *Development of the technical infrastructure*. Under Polish conditions, the development of technical infrastructure is the most costly item in the regional policy budget and is under-developed.

- *Non-material means for supporting regional development*. This is a new component of regional policy, taking various forms, such as providing access to information and advice, education and training and support for research and technological development. Measures aimed at developing the business environment do not cover the entire country.

There are also specific schemes and forms of assistance which contain an element of regional policy.

- *Support for Restructuring Enterprises*. In the past, the beneficiaries have been nine industrial sectors (with automobile, iron and steel, fuel and chemical industries benefiting most). The second type of support within this scheme (EFSAL) is offered to enterprises and State Treasury corporations, undergoing restructuring and applies mostly in regions with high structural unemployment (in Lodz and Katowice voivodships and in some local communities in Walbrzych).

- *Support for Regional Programmes*. The aim is to provide additional financing for infrastructural investment in some regions of the country (mainly regions threatened with high structural unemployment) and for improvements in communal infrastructure.

- *Special Economic Zones:* designed to contribute to the development of regions threatened with structural unemployment.

The current government acknowledges the fact that any attempts to reduce regional disparities need to be undertaken with the EU regional assistance framework in mind. Using EU policies and strategies attempts are being made to promote public-private partnerships. The following Phare sponsored programmes operate in Poland:

- The original Phare-STRUDER programme was modelled on the EU Structural Funds programmes. It covered six regions (Olsztyn, Suwalki, Katowice, Lodz, Walbrzych and Rzeszow). Its extension, the STRUDER II, is aimed at promoting economic development in areas affected by economic restructuring.

- Phare-RAPID ( Rural Areas Programme for Infrastructure Development) is aimed at diminishing regional disparities though infrastructure developments in areas lagging behind.

- The PHARE-CROSSBORDER programme began in Poland in 1994 and incorporates seven projects. One of the areas covered by this programme, the Polish-German border, is seen as a kind of laboratory for integration processes on the fringe of the EU (Stryjakiewicz, 1997).

- Other Phare-financed programmes are: The *Local Initiatives Programme* aimed at assisting selected localities in their efforts to prepare local development strategies. Similar to several other PHARE programmes, it has been managed by the Co-operation Fund, a governmental agency created to coordinate several externally financed programmes. The programme is an interesting exercise in mobilising local communities around common goals. The *Municipal Service Restructuring and Privatisation Programme* is another major attempt at changing the institutional and economic structure of several municipalities in Poland.

Outside PHARE, there are important initiatives supporting Polish regional and especially local development: the *Polish-British Programme for the Support of Local Governments,* financed by the British Know-How Fund; and the *Polish-Swiss Regional Programme*, financed by the Swiss government to support selected rural areas. Without questioning the efficiency of these programmes, it has been acknowledged that most foreign assistance remains uncoordinated at the regional level.

### *6.4.4 Designated problem regions*

Although there is no explicit regional policy operating in Poland, as early as 1990 there was an attempt to establish criteria for central government assistance to problem regions. In early February 1993, there were also attempts to cope with specific ‘problem’ regions such as Walbrzych and Lódz and a plan for regional restructuring was formulated. This plan included a timetable for pit closures and social allowances for laid-off employees based on state funds. Up to now, the results are rather modest and the intensity of activity low.

Pressure coming from the most difficult region in Poland, Upper Silesia, resulted in another initiative, the signing of the *Contract for the Katowice Voivodship*. The restructuring of Polish coal mining is inseparable from the restructuring of the

Katowice voivodship as it contains 64 of the 66 operating coal mines in the region. Given the urgency and importance of the problem, in 1995 the representatives of regional government and other socio-political organisations prepared a document entitled the Regional Contract for the Katowice Voivodship to co-ordinate a concerted approach to regional development among State and non-State actors at different levels.

With rapid growth of unemployment and its strong spatial differentiation, problem areas became synonymous with "areas threatened with particularly high structural unemployment" (COP, 1995). From 1991 to 1993, they were listed in resolutions of the Council of Ministers and since then in ordinances of the Council of Ministers. The list of those areas kept on growing and covered a large proportion of the country. In 1994, the "threatened" areas included 412 municipalities (gminas) situated in 26 voivodships, which accounted for 22 percent of Poland's territory inhabited by 15 percent of the population. The Council of Ministers ordinance of 24 January 1995, added 79 more gminas to the list. Therefore, in 1995, the threatened areas covered 491 gminas in 27 voivodships (including all of Elblag, Lodz, Slupsk and Walbrzych voivodships and major parts of Koszalin, Olsztyn, Pila and Suwalki voivodships). They accounted for about 26 percent of Poland's territory and were inhabited by 18 percent of the population but 28 percent of the unemployed (see map).

Problem areas are also assisted by the Phare programmes, as discussed in the previous section. In 1994, the Phare STRUDER programme covered voivodships representing both the underdeveloped agricultural regions (Olsztyn and Suwalki voivodships), old industrial districts ( Lodz, Katowice, Walbrzych) and areas with one-factory towns (Rzeszow). Up to June 1996 the STRUDER programme had invested more than 104 million ECU in more than 800 production investments undertaken by SMEs. The Phare-STRUDER-II programme is primarily aimed at promoting economic development in selected regions, which were affected by economic restructuring processes. The programme covers 14 voivodships (see map), with an implementation period of 1997-1999. The Phare-INRED programme is aimed at preparing Poland's regions for efficient and effective utilisation of Structural Funds between May 1998 and December 1999 (see map).

General observations based on the appraisal of the way in which the Polish government dealt with problem regions, leads to the following conclusions. First, the government came to realise that centrally-allocated funds should play an important role in the process of restructuring and regional development, especially in problem areas. Second, that the sources and extent of assistance to regional development will be defined by annual budgets, and, more importantly, from 1996, the pace of growth in spending for this area will be faster than the rate of growth of overall State expenditure. Third, experience of the last few years points to a promising start for the implementation of EU aid programmes relating to regional development.

### 6.5 Summary

Economic transformation in Poland has, as in the other CEE countries, had a significant spatial impact. There is growing regional differentiation between the leaders and laggards in economic development, with a number of factors including out-migration, labour market difficulties (including high unemployment) and lagging GDP levels affecting poorer regions – often located on the eastern periphery of the country. Regional development policy, however, was sidelined at the start of the 1990s and has only risen on the political agenda in more recent years, promoted particularly by the process of negotiation for EU accession. Further, policy development in this field has significant knock-on effects, particularly in terms of institutional division and leadership both within central government and at sub-national level.

More recent reform, particularly the territorial administrative change at the start of 1999, has, however, laid a more solid basis for future development in the regional policy field. The positive operation of many of the regional development agencies, as well as achievements at municipality level, are also notable. Outstanding critical decisions include the need for the allocation of responsibility within the central government for regional policy and the working out of a coherent national strategy for development. This strategy must define priorities and objectives, implementation and coordination channels and the possibility for monitoring and evaluation. While much work is still required, recent developments have paved the way for significant progress in the near future.

# 7. REGIONAL DEVELOPMENT IN SLOVENIA

## 7.1 Reform and transition: the context for regional development

Slovenia achieved independence in October 1991 and, despite problems related to the disintegration of the former Yugoslavia, the country has benefited from earlier experiences in self-management based on a quasi-market system. Yugoslavia had also been exposed democratic and market economic influences through trade and free mobility of people during the 1960s. In Slovenia, production levels still fell sharply initially but economic growth and industrial output have increased strongly since 1993. Per capita GDP growth is now among the highest in the transition countries and rivals that of EU countries such as Greece and Portugal. In 1997, GDP grew by 3.8 percent and the estimate for 1998 was increased growth of 4.0 percent.

Slovenia accounted for one fifth of the former Yugoslavia’s output and almost one third of its exports, with only eight percent of its population. The country has been able to build on this economic strength and would qualify for the single currency on the Maastricht budget deficit and public debt criteria. Government finances are more balanced than is the norm in CEE countries and the country had a budget surplus equivalent to 0.3 percent of GDP in 1996, although a deficit equivalent to one percent of GDP was expected in 1998.

The principal problems facing Slovenia relate to consolidation of its strong position and accelerating reform to ensure and develop its competitiveness. One area particularly highlighted by critics is the country’s ambivalent attitude to foreign participation. This is exemplified by the debate over foreign property rights and actions by the strong independent Bank of Slovenia to curb foreign capital inflows, considered by the bank to be undermining the operation of monetary policy. This is deterring foreign investors and there are some fears that this will deprive the corporate sector of funds needed for restructuring. An estimated $2 billion has been invested in Slovenia, although some of this total came into the country prior to independence when the larger potential Yugoslav market was available; current flows are generally to enterprises with existing foreign partnerships. Austria is one of the principal investor countries, accounting in 1996 for 34 percent of the total FDI stock.

Privatisation has been relatively slow, despite a law passed in 1992 allowing companies to select their favoured privatisation method, although this process is now progressing steadily. Industrial production and exports have also recently undergone difficulties, with labour-intensive industries such as textiles and leather being among the hardest hit. The country is highly export dependent and 65 percent of exports in 1996 went to the European Union, 30 percent to Germany alone. This represents a considerable turnaround from its previous dependence on former Communist countries.

The separation of powers between executive, legislature and judiciary has been completed. Other market economy related institutions have also been put in place, such as the Ljubljana stock exchange, established as early as 1989. The coalition government of the three major (liberal/social democratic) parties maintained stability in the first half of the 1990s. Political deadlock followed the 1996 elections, but was finally resolved with the formation of a coalition of the two largest parties, the centre-left Liberal Democrats and the centre-right Slovenian People's Party. Minorities enjoy considerable rights in Slovenia, and the Italian and Hungarian minorities retain one seat in the parliament.

**Table 32: Economic summary**

| Indicator | 1997 |
|---|---|
| GDP (tolars billions) | 2,907 |
| Estimated level of real GDP (1989=100) | 99 |
| GDP per capita ($) | 9,101 |
| Inflation rate (annual ) | 8.8 |
| Share of industry in GDP | 28.7 |
| Unemployment rate (% ) | 14.4 |
| Current account / GDP (%) | 0.2 |
| Trade balance (USD billion) | -0.8 |
| *Exchange rate £1= 313 tolars (end 1999)* | |

Source: EBRD, 1998

## 7.2 Regional disparities and problems

There are considerable data problems in Slovenia associated with the measurement of regional disparities. There are no GDP data at regional level, and income tax and gross value added indicators are used as alternatives. These indicators, however, do not provide a complete picture as they exclude elements such as agriculture and some services. Three different measures for unemployment also exist: ILO measurements which are not available at regional level; registered unemployment; and unemployment among the working population. Despite these difficulties, the following section provides a broad overview of the main regional patterns and disparities evident in Slovenia as the context for the regional policy section. The regions referred to in this section are the 12 statistical planning regions (see section 7.3.1 and map).

### *7.2.1 Patterns, trends and factors*

Slovenia is a small country in *population* terms, with a total population of just under two million people. The demographic indicators have been worsening, characterised by a falling birth rate but rising life expectancy. This is resulting in a significant ageing of the population, particularly notable in remote agricultural areas. In ethnic terms, the population is relatively homogenous, with over 85 percent of the total population being Slovenes, and Italians and Hungarians comprise the two largest groups of ethnic minorities. In general, the demographic indicators in western Slovenian regions are better than those in eastern areas.

Population density in Slovenia is just under 100 inhabitants per $km^2$, although considerable regional variation is evident. This is principally a result of the concentration of the population in urban areas and 75 percent of the population live on one fifth of the territory. The capital, Ljubljana, has around 260,000 inhabitants. De-populating areas account for around 40 percent of the territory where average population density is below 35 inhabitants per $km^2$. These areas are generally agricultural or peripheral areas, located particularly on the Croatian and Italian borders.

In terms of *labour market* developments, regional differences in Slovenia are marked, reflecting the very different regional economic structures. Three regions are still strongly agricultural (Pomurska, Dolenjska and Posavska) where employment in agriculture in the early 1990s still exceeded 20 percent. Central Slovenia, containing Ljubljana, and Obalno-Kraska (Littoral Karst), a tourism centre, have a large proportion of their economically active population in the service sector, while the Zasavska region is the most industrialised in the country.

The rise of unemployment since the early 1990s has been one of the most important ramifications of economic and political reform. This phenomenon has been evident throughout the country, including in regions where unemployment was previously virtually unknown. The scale of regional variation has increased, rising from 1:2.2 in 1992 to 1:2.4 in 1994. It is, however, important to note that the disparities between regions are not increasing dramatically, given the rise of unemployment in regions formerly characterised by low rates and the overall stability of rates in regions with higher unemployment. In 1997, above-average unemployment rates were principally evident in the eastern regions of the country.

Regional disparities are also evident in *economic activity*, although this cannot be measured on the basis of GDP because of the lack of available data. Unsurprisingly, Central Slovenia, with the influence of Ljubljana, is one of the economically strongest regions accounting, for example, for 38.4 percent of total Slovenian business profits. The focus of economic growth on services has also favoured the Capital. Western regions in general showed better economic indicators, with more profitable businesses and higher rates of new firm formation. Overall, regional economic disparities, as measured by value added per capita, increased slightly from 1:2 in 1992 to 1:2.8 in 1997; Central Slovenia was around 20 percent above the national average in 1996 and this 1:6 ratio has been relatively stable since the start of the 1990s.

### *7.2.2 Regional problems*

In line with the trend in many of the CEE countries, the Slovenian regions which have been particularly affected by the transition to a market economy are those whose economic structures are strongly influenced by heavy industry such as mining, chemicals, textiles and steel. In addition to industrial problems, many of these regions also suffer from considerable environmental damage. Agricultural underdevelopment is prevalent in some regions, although others have shifted more successfully towards tourism. Regions with a higher ratio of tertiary activities have had fewer difficulties in adjusting to new economic conditions. Table 33 provides an overview of unemployment and income tax base indicators at regional level.

**Table 33: Economic indicators for Slovenia by region**

| Region | Unemployment 1997 (% of working age pop'n) | Income tax base per capita 1994 (national average = 100) |
|---|---|---|
| Central Slovenia | 7.7 | 119.4 |
| Obalno-Kraska (Littoral Karst) | 7.7 | 113.3 |
| Gorenjska | 8.6 | 101.3 |
| Goriska | 6.5 | 108.5 |
| Savinjska | 11.3 | 92.9 |
| Dolenjska | 9.5 | 95.7 |
| Pomurska | 12.8 | 78.4 |
| Kraska (Karst) | 8.0 | 100.0 |
| Podravska | 16.0 | 83.9 |
| Koroska | 8.5 | 86.5 |
| Posavska | 12.0 | 85.1 |
| Zasavska | 12.2 | 96.5 |
| **Slovenia** | **10.2** | **100.0** |

Source: Institute for Macroeconomic Analysis and Development

In terms of overall patterns, the western regions bordering Italy and Austria show generally better development levels than the eastern counterparts. However, the east-west divide is not as marked as in other CEE countries. The methodology of the (Slovenian) Institute for Economic Research and the Institute for Urban Planning groups the Slovenian regions into the following categories.

- *Most economically developed* - comprising Central Slovenia, Littoral-Karst and Gorenjska, all of which have experienced a lower than average fall in employment levels and, since 1994, decreasing unemployment. The share of services is much higher than the national average in Central Slovenia and Littoral Karst in particular, and all three regions have very positive future development prospects.

- *Medium developed regions with positive development potential* - including Goriska, Savinjska and Dolenjska. The per capita gross value added of these three regions is around the national average, with Dolenjska, the most export-oriented of the Slovenian regions, showing the most positive indicators. Unemployment, however, is increasing faster than the national average. Goriska has experienced strong economic growth and does not suffer from a heritage of obsolete industrial structures. Savinjska has the most economic difficulties, related in part to the high proportion of large companies.

- *Medium developed regions* - comprising Podravska, Koroska and Posavska. These regions have some difficulties inherent in their economic structures but all contain good development potential. The break-up of the former Yugoslavia affected the markets of these regions, which had industrial traditions, but the gross value added has been improving in all three cases. Unemployment remains the most difficult problem facing future development.

- *Less developed regions* - including Pomurska and Karst (Kraska) where the gross value added per employee is only 55-61 percent of the national average. The weaknesses of the regions include adverse demographic conditions (including de-population and ageing), high unemployment (in Pomurska) and mono-company structures. Agriculture plays an important role in the economies of both regions.

- *Industrial decline* - Zasavska region, which is dominated by the mining industry and characterised by large industrial enterprises which have been difficult to modernise. The region has falling gross value added, and the percentage of unemployed in the working age population is 25 percent higher than the national average.

## 7.3 Administrative/institutional structures for regional development

### *7.3.1 Territorial administrative structures*

Slovenia is a unitary state comprising two principal tiers of administration - central government and municipalities. The constitution of the Republic of Slovenia guarantees the right to local self-government and a series of laws was passed at the start of the 1990s which formed the basis for the reform of local self-government and national administration. The first stage of this reform was undertaken in 1994 with the creation (from a former base of 62) of 147 municipalities and 11 city municipalities (see map). This number has recently been raised to a total of 192 municipalities.

The responsibilities of the local self-governments in Slovenia include:

- guaranteeing the right of the population to make decisions on public matters best realised through the municipality as the basic local self-government community;

- maintaining quality of life for local communities;

- ensuring the division of State administrative functions between the State and the municipalities and undertaking rational and efficient local administration; and

- facilitating the uniform development of all communities.

The high number of municipalities means that some are extremely small in size and the structure is very fragmented. The smallest municipality has only around 430 inhabitants. While the constitution permits municipalities to cooperate in larger groups to solve common problems, this process is voluntary and generally relates to practical issues such as water or waste planning.

A key issue of current debate in Slovenia is the creation of an intermediate regional tier of administration. At present, no formal regions exist, although individual Ministries and national organisations use different regional breakdowns, usually of between 8-12 regions, in the administration of their activities. It is estimated that as many as 40 different regional divisions co-exist in the country. Twelve statistical planning regions (see map) are used by Eurostat as the basis for NUTS III designation - although these regions have no elected representatives or established administration. The recently elaborated regional strategy for Slovenia proposes that, at least in the interim, these 12 regions are used as economic development regions. As such, they could act as a base for the coordination of national policies and oversight of municipality activity. There is also currently a law under discussion in Parliament on the creation of provinces, although this is only at a very early stage.

The debate on the creation of intermediate tiers of government is highly political, with both national and municipality governments fearing a loss of power. There is also differing opinion within the central government as to the optimum size of the new regions - although those created are likely to be small in European comparison regardless of the final structure. In theory, the establishment of an intermediate tier is recognised as important given the regionalisation trend in Europe, the accession of Slovenia to the EU and the future intervention of the Structural Funds, as well as for reasons of internal administrative and governance. The resolution of this issue presents a difficult challenge to the future development of regional policy in Slovenia.

## 7.4 Regional development institutions

### *7.4.1 Central government*

The jurisdiction for regional policy lies with the Ministry of Economic Relations and Development (MoERD) and its department for regional development. This department is responsible for the budget used in support of demographically endangered areas (the assisted areas of the country) and commissioned the drafting of the new regional strategy for Slovenia. The Institute of Macroeconomic Analysis and Development, part of the MoERD, is also of central importance to the development of regional policy in the country. The Institute is the successor to the former Institute for Social Planning which, following Slovenian independence, was split between the MoERD and the Ministry for Environment and Physical Planning. The main tasks of the Institute include:

- the macroeconomic analysis of economic, social and regional development;
- the analysis and coordination of the direction and tasks of economic policy;
- the provision of advice on economic and regional policy;
- the elaboration of the Strategy for Economic Development for Slovenia; and
- policy evaluation.

The Institute was also involved in the drafting of the new regional strategy for Slovenia.

The other Ministry of relevance to regional development is the Ministry of Environment and Physical Planning, combining spatial planning, environmental and housing responsibilities. It includes the National Office for Physical Planning whose remit covers physical and urban planning, the elaboration of national and regional structure plans and spatial information systems.

In common with many CEE countries, sectoral interests, more than regional concerns, have tended to dominate budgetary spending and economic development in Slovenia. The level of cooperation between national government Ministries has improved over the last couple of years, partly as a result of external intervention from the European Commission and renewed requirement to work together in fields such as regional policy, but considerable progress is still required. While an inter-Ministerial task force for the development of regional policy was established in 1996, the European Commission's Opinion on Slovenian membership notes that "ministerial responsibility for regional development policy and spatial planning is in need of strengthening and… the institutional structure seems embryonic with low interministerial coordination". This requirement, together with the need for the coordination of sectoral budgets which have a spatial impact in their implementation is one of the key emphases of the new regional strategy and draft law on regional policy and development. This is particularly important in the light of declining budgets for specific regional development purposes.

### *7.4.2 Regional/local authorities and agents*

Sub-national authorities have not had any significant involvement to date in the design or administration of regional policy in Slovenia. The policy measures of this area are administered centrally and available to eligible municipalities through a system of open tender. It is interesting to note that local initiative and innovation in city and municipality administrations was thought to have been strengthened through the polycentric regional development approach undertaken prior to 1990 (Ministry of Environment and Physical Planning, 1995). The lack of an intermediate regional tier of territorial organisation presents a barrier to the implementation of a new regional policy operating on the principle of partnership. The local authorities are generally too weak or too small for active partnership participation with national authorities or cross-border partners.

Many of the national Ministries have agencies working at sub-national level, using their own specified regional grouping. Regional offices of the Ministry for Environment and Physical Planning are proposed to encourage planning competencies at sub-national level. Some other organisations such as the Promotion Centre for Small Businesses operate regional networks for the implementation of their activities. In general, however, there is little coordination of these sub-national organisations.

## 7.5 Regional policy

### *7.5.1 Evolution of regional policy*

Slovenia has undertaken some form of regional development policy since the early 1970s. A special law was passed in 1971 to provide a more coordinated approach to this policy area and promote balanced development throughout the country. A polycentric concept of development was dominant at that time in an attempt to reduce the economic disparities between geographical areas in Slovenia and establish equality in standards of living. Regional measures were relatively successful in the 1970s but, with economic stagnation in the 1980s, the relative position of underdeveloped agricultural regions and certain regions with industrial and mining foci became more unfavourable.

In 1990, the focus of regional policy shifted towards 'demographically endangered areas' in an attempt to halt out-migration and the de-population of highland and peripheral areas. This move was related in part to the fact that high inflation and considerable hidden unemployment masked the difficulties in industrial regions. New areas were designated and measures were promoted to stop or minimise the out-migration of people from these areas. This regional policy direction is still in force in Slovenia.

A new Bill on the Promotion of Regional Development in Slovenia had its first reading in Parliament in 1995. The Parliament then proposed that a regional development strategy be put in place before the law was passed. This strategy has now been developed and is currently under debate. Key proposals incorporated in the new law include:

- the designation of new assisted areas;
- the creation of a National Regional Development Council for the coordination of central government spending;
- a move away from the traditional incentive based approach to regional development towards the support of more endogenous development initiatives; and
- the establishment of an information system for monitoring and evaluation.

The new proposed law would widen the scope of regional policy to include the promotion of service activities, in addition to manufacturing investment, as well as the support of R&D, business services and economic infrastructure in the encouragement of innovative regional milieux.

### *7.5.2 Concepts and objectives*

The basic objectives of current Slovenian regional policy, focused on the support of rural and demographically endangered areas, include:

- the improvement of working and living conditions in rural areas and the maintenance of the current population levels in areas subject to previous heavy de-population;
- in order to promote the above, the creation of additional income opportunities for the rural population, both in agriculturally-related and in non-agricultural areas; and

- the establishment of a socially more attractive environment and heightened quality of life in demographically endangered regions to encourage the local population, and particularly those in younger age groups, to remain in the region.

Two principles underlie the operation of Slovenian regional policy. First, all possible local resources should be utilised to achieve policy objectives including land, labour force, raw materials, traditional skills etc. Second, the local population should participate as far as possible in the preparation and drafting of development projects from an early stage to ensure greater ownership of the programmes and a higher level of understanding of the issues and choices facing the region.

The relatively narrow focus of regional policy on peripheral and demographically endangered regions has limited its effectiveness in Slovenia. There has been little recognition of the links and mutual dependence within wider territorial units. The targeted focus on small areas has ignored the fact that the overall economic potential of the wider region was often being drained by areas undergoing industrial decline. Industrial problem areas, as well as those with severe environmental problems, have been a notable exclusion from regional policy in Slovenia. Industrial-related difficulties have generally been addressed under sectoral policy with companies often being assisted on a case-by-case basis.

The new law on regional development, currently under preparation, aims to address some of these issues as well as align its objectives, instruments and institutional structures with the principles of EU regional policy. The drafting of a regional strategy for Slovenia has been one of the first stages in the preparation of the new law. This strategy has been drafted for the Ministry for Economic Relations and Development by a range of Slovenian institutes in conjunction with other relevant advisors.

The aim of the regional strategy is to raise awareness of regional policy and promote a shift away from the previously sectoral orientation of economic development towards a more regionally-based approach. The strategy proposes change in a number of important areas.

- The strategy emphasis is placed on the coordination of the economic policies and budgets of different Ministries, with the aim of increasing the efficiency of government measures and ensuring that the regional impact of activities is taken more into account.

- The creation of a National Regional Development Council or Board is proposed, comprising individual State secretaries and with the task of coordinating the separate Ministries. This Council would be the forum for regional development related issues.

- The strategy proposes the creation of a central regional development agency (RDA) in Ljubljana with a network of ca. 10 RDAs operating at regional level. The 12 statistical planning regions would be used as the basis for the location of the sub-national agencies. The RDAs would act as a coordination point for national top-down policies and incentives and bottom-up municipality-based initiatives. Other options exist for the possible basis for future RDAs such as the regional promotion centres and local initiatives linked to the Promotion Centre for Small Business which coordinates a network of SME support in the country.

- The designation of common criteria for state incentives is suggested to make the overall system more transparent and coordinated.

### *7.5.3 Policy instruments*

A number of different policy instruments are used for the support of demographically endangered areas in Slovenia. These include:

- the co-financing of the elaboration of development programmes;
- the co-financing of local infrastructure investment;
- soft loans or interest rate subsidies to promote direct investment in business activities;
- tax concessions; and
- special measures in the field of social services eg. vocational training, culture, basic health services etc.

Two principal forms of financing exist for regional development support. The first comes from the budget of the Ministry of Economic Relations and Development and comprises grants and loans available to municipalities on an open tender basis. The share of the state grant should not exceed 30 percent of the total investment, or 50 percent in border areas. The budget for this support, which has decreased during the 1990s in light of overall public expenditure restrictions, is given in Table 34.

**Table 34 : Budget for the MoERD support of demographically endangered areas**

| Year | Tolars (million) | % GDP | $ per capita |
|---|---|---|---|
| 1991 | 865 | 0.25 | 16 |
| 1992 | 1499 | 0.15 | 9 |
| 1993 | 1380 | 0.10 | 6 |
| 1994 | 1630 | 0.09 | 6 |
| 1995 | 1203 | 0.05 | 5 |
| 1996 | 1131 | 0.04 | 4 |
| 1997 | 1229 | 0.04 | 4 |

Source: Institute for Macroeconomic Analysis and Development

The second source of funding is the Regional Development Fund, created in 1995, and financed principally on the basis of privatisation receipts. The Fund offers low interest loans and guarantees in demographically endangered areas for productive investment by SMEs and small agricultural businesses. It can also provide short-term bridging loans for municipality infrastructure projects. In 1997, the RDF had a small budget of 940 million tolars (ca. 5 MECU). Financial difficulties are anticipated over the next 2-3 years as privatisation revenues decline and the repayment of loans already granted is not yet complete.

The proposed new law for regional development anticipates the support of direct productive investment in the regions (particularly by SMEs) through soft loans and interest subsidies and/or guarantees for foreign or domestic bank loans. Grants would only be used in exceptional circumstances.

### *4.4 Designated problem regions*

Slovenia has had officially designated assisted areas since the start of the 1970s. The pattern of assisted areas changed during the 1970s and 1980s, although the overall population coverage remained broadly similar. Under the first 1971 law, assisted areas encompassed 18 percent of the total population and this figure had fallen to 16 percent in the 1986-1990 period. The current assisted areas map was designated under the new law in 1990, which re-focused regional policy on 'demographically endangered areas', and included a demographic ageing index and the rate of population growth as designation criteria. The map now encompasses 55.2 percent of the territory of the country and 24.6 percent of the population (see map).

The draft law on regional policy proposes a new set of objectives for the designation of assisted areas which are more in line with EU structural policy. The proposal foresees designation based on municipalities and in the following groupings:

- *underdeveloped regions* - comprising (i) regions with per capita income tax of less than 75 percent of the national average, and (ii) border areas with negative demographic trends (eg. a negative population index over the period 1981-1991);

- *industrial problems areas* - based on indicators such as industrial structure, industrial decline and unemployment rate; and,

- *border regions/areas of national park* - including areas where a significant proportion of the territory is national park with limited development potential or possibilities.

### 7.6 Summary

There is a history of regional policy design and implementation in Slovenia, including the designation of assisted areas and the targeting of financial support. Since the law on regional policy in 1990, the focus has primarily been on the support and development of so-called 'demographically endangered areas' which encompass around 55 percent of the area of the country, although only a quarter of the population. The main aim is to improve living and working conditions and create new economic opportunities to prevent out-migration and the de-population of these areas. This is a relatively narrow focus and leaves important issues such as the tackling of industrial decline to sectoral interests. Regional policy is officially under the jurisdiction of the Ministry of Economic Relations and Development.

Important reforms to the regional policy structures are currently under debate in Slovenia. A new law on regional policy is being debated in Parliament which includes proposals relating to new problems areas more in line with those used in the EU, the creation of a National Regional Development Council for the coordination of regional policy and a shift in focus towards the more explicit promotion of endogenous development. As a preparatory stage in the discussions on the law, a regional development strategy for the country has been elaborated. The strategy addresses related issues such as the coordination of sectoral budgets and the creation of decentralised regional development agencies.

A key requirement in Slovenia from a regional development viewpoint is the need to establish an intermediate regional level of authority in the country. Slovenia currently has only two tiers of administration, the central government and 192 municipalities. Individual Ministries and national organisations use differing regional breakdowns for the implementation of their activities and 12 statistical planning regions exist, although without any elected representation or established administration. There is currently considerable debate about the final structure of the regional level, and the nature of the competencies that should be devolved to it. The resolution of this issue presents one of the key challenges for the future design and implementation of regional policy in Slovenia.

## References

Andrele, A (1998) EU Enlargement, Cohesion and Regional Policy (unpublished), Prague.

Bachtler J, Raines P and Downes R (Eds.) (1997) *The Impact of EU Enlargement on Economic and Social Cohesion*, Report to the European Commission (DGXVI), EPRC, University of Strathclyde, Glasgow.

Bachtler J (Ed.) (1992) *Socio-economic situation and development of the regions in the neighbouring countries of the Community in Central and Eastern Europe,* Regional Development Studies 2, DG XVI, Office for Official Publications of the European Communities, Brussels.

Blanchard, O, Commander, S and Coricelli, F (1995) Unemployment and Restructuring in Eastern Europe and Russia, in: Commander, S and Coricelli, F (Ed.) *Unemployment, Restructuring and the Labour Market in Eastern Europe and Russia,* Economic Development Institute of the World Bank, Washington.

Blotevogel, H and Russell, K (1996) Economic Restructuring: Demographic Responses and Feedbacks, *European Urban and Regional Studies*, Vol. 3, No. 2.

Boeri, T (1997) Learning from Transition Economies: Assessing Labour Market Policies across Central and Eastern Europe, *Journal of Comparative Economics*, No.25.

Burda, M (1993) Unemployment, Labour Markets and Structural Change in Eastern Europe, *Economic Policy,* 8*/16*.

Burda, M and Lubyova, M (1995) *The Impact of Active Labour Market Policies : a Closer look at the Czech and Slovak Republics*, Discussion Paper No. 1102, Centre for Economic Policy and Research, London.

Cséfalvay, Z, Fassmann, H and Rohn, W (1997) Neue regionale Disparitäten in Ungarn, In: Fassmann, H (Ed) (1997) *Die Rückkehr der Regionen - Beiträge zur regionalen Transformation Ostmitteleuropas*, Beiträge zur Stadt- und Regionalforschung Vol. 15, Verlag der Österreichischen Akademie der Wissenschaften, Vienna

Czech Statistical Office (1996) *Main Economic Indicators*, No. 2.

Department of Trade and Industry (1998a) *Open for Business Central Europe*, 1 March.

Department of Trade and Industry (1998b), *Czech Republic – Economic Round-Up,* Overseas Trade Services, June-July.

Done, K and Grimston, J *et al* (1997) *Financial Times Survey: Slovenia,* Financial Times, 28 April 1997

Downes, R and Horvath, G (1996) *The Challenge of Regional Policy Development in Hungary*, Regional and Industrial Research Policy Series, No. 15, European Policies Research Centre, Glasgow

Dunford M and Smith A (1998) *Trajectories of change in Europe' regions: cohesion, divergence and regional performance*, Paper to Workshop "Regional Inequality in an Enlarged Europe: Regional Performance and Policy Responses' Centre on the Changing Political Economy of Europe, Sussex European Institute, 12-13 March 1998.

The Economist (1995) *Eastern European demography - of death and dying*, 7 January.

Estonian Regional Development Agency (1998) *Newsletter*, No.1 (1), June, Tallinn.

European Bank for Reconstruction and Development (1998) *Transition Report 1998*, EBRD, London.

European Bank for Reconstruction and Development (1997) *Transition Report 1997*, EBRD, London.

European Commission (1997) *Commission Opinion on Hungary's Application for Membership of the European Union*, DOC/97/16, European Commission, Brussels

European Commission (1997) *Commission Opinion on Estonia's Application for Membership of the European Union*, DOC/97/12, European Commission, Brussels.

European Commission (1997) *Commission Opinion on Slovenia's Application for Membership of the European Union,* DOC/97/19, European Commission, Brussels

European Information Service (1998) *Monthly Report on Europe*, April.

EU Phare Regional Development Group (1998) *EU Support to Regional Development in Estonia*, Summary paper, Tallinn.

Fassman H (Ed.) *Die Rückkehr der Regionen: Beiträge zur regionalen Transformation Ostmitteleuropas*, Beiträge zur Stadt- und Regionalforschung, Band 15, Vienna.

Financial Times (1998a) *Prosperous postcard view belies true picture*, 14 May.

Financial Times (1998b) *Sell-offs continue*, 14 May.

Financial Times (1998c) *Czech Budget. Premier plans deficit*, 15 September.

Financial Times, (1998d) *Estonia*, Financial Times Survey, 24 February.

Financial Times (1998e) *Applicants invited to start admission talks*, 2 July.

Financial Times (1997a) *Sector's rush to modernise*, 1 December.

Financial Times (1997b) *Paying the price for hesitation*, 1 December.

GUS (1997) *Rocznik Statystyczny Wojewodztw,* Central Statistical Office of Poland, Warsaw.Gorzelak, G (1996) *The Regional Dimension of Transformation in Central Europe,* Jessica Kingsley Publishers, London.

Gilowska, Z and Misiag, W (1995) *Decentralizacja polskiego systemu budzetowego, (Decentralisation of the Polish Budgetary System),* Instytut Badan nad Gospodarka Rynkowa, Gdansk-Lublin.

Gorzelak G (1996*) The Regional Dimension of Transformation in Central Europe*, Jessica Kingsley Publishers, London, pp.152.

Gorzelak G and Kuklinski A (Eds.) (1994) *Dilemmas of Regional Policies in Eastern and Central Europe,* European Institute for Regional and Local Development, University of Warsaw.

Gorzelak, G and Jalowiecki, B, Strategic Choices and Poland's Regional Policy, in: Kuklinski, A (Ed.) *European Space. Baltic Space. Polish Space*, University of Warsaw.

Government of the Hungarian Republic (1998) *National Regional Development Concept*, Background Document of the Parliament's Resolution No. 35/1998 (III.20.)OGY, Budapest

Grime, K, Kovács, Z and Duke, V (forthcoming 2000) The Effects of Privatisation on Households in three Central European Capitals In: Bachtler, J, Downes, R and Gorzelak, G (Eds) (forthcoming 2000) *EU Enlargement, Cohesion and Regional Policy*, Ashgate Publishers, Aldershot.

Hajdu Z and Horvath G (Eds.) (1994) *European Challenges and Hungarian Responses in Regional Policy,* Centre for Regional Studies, Hungarian Academy of Sciences, Pecs.

Harter, M. and Jaakson, R. (1997) Economic Success in Estonia: The Centre versus Periphery Pattern of Regional Inequality, *Communist Economies and Economic Transformation,* Vol. 9 no. 4.

Hausner, J, Kudlacz, T and Szlachta, J (1995) *Regional and Local Factors in the Restructuring of Poland's Economy. The Case of South-Eastern Poland*, Krakow.

Horvath, G (1998) *Regional and Cohesion Policy in Hungary*, Discussion Paper No. 23, Centre for Regional Studies of Hungarian Academy of Sciences, Pécs

Iwaskiw, W.R.(Ed.) (1996) *Estonia, Latvia and Lithuania: country studies*, Federal Research Division, Library of Congress, Washington DC.

Kajzer, A (Ed.) (1998) *Slovenia - Analysis of Economic Developments and Target Developmental Scenario by 2002 (Spring Report 1998),* Institute of Macroeconomic Analysis and Development, Ljubljana

Klaus, V (1996) ‘Czeching into Capitalism’, *CATO Policy Report*, Vol. 18, No. 2.

Kozak, M (2000 forthcoming) Regional Development Policy in Poland in the 1990s in: Bachtler, J, Downes, R and Gorzelak, G (eds) *EU Enlargement, Cohesion and Regional Policy*, Ashgate Publishers, Aldershot.

Kozak, M (1998) *Poland’s Regional Development in the Context of the EU Accession*, Paper presented at ‘EU Accession and Regional Development’ Conference, Phare, Tartu, Estonia, 14-16 June.

Klasik, A and Szlachta, J (1991) *Regional Restructuring of Industry in Poland*, OECD Seminar on Regional Industrial Restructuring, Maastricht, 8-9 October.

Kuklinski, A, Mync, A and Szul, R (1997) *Polish Space at the Turn of the 20th Century*, EUROREG, Warsaw.

Lugus, O. (1997) Situation and Prospects of Estonia, in: Rheinisch-Westfälisches Institut für Wirtschaftsforschung and European Policies Research Centre (1997) *Preparation for the First Report on Economic and Social Cohesion: the impact on cohesion of EU enlargement*, Report to the European Commission, Volume I.

MacLean, C. (1997) Record Investment Flows Point to Estonia’s Development, *Estonian Trade and Investment Review*, Estonian Chamber of Commerce and Industry and the Estonian Investment Agency, Tallinn.

Ministry for Agriculture and Regional Development (1998) *Regional Development in Hungary*, Budapest

Ministry for Agriculture and Regional Development (1998) *New Developments and Policies in Hungary*, Budapest

Ministry of Environment and Physical Planning *et al* (1995) *Slovenian National Report Part A*, Report for Second United Nations Conference on Human Settlements, Ljubljana

Molle W (1998) *Economic integration and cohesion in Europe: past and future*, Paper to Internbational Conference “EU Accession and Regional Development, 15-16 June 1998, Tartu, Estonia.

Nøraard, O., Hindsgaul, D., Johannsen, L. and Willumsen, H. (1996) *The Baltic States after Independence.* Edward Elgar, Cheltenham, Gloucestershire.

Nunnenkamp, P (1997) Governing the Economic Transition of Hungary, Poland and Former Czechoslovakia, *Journal of International and Comparative Economics*, Vol. 5.

OECD (1996a) *Regional problems and Policies in the Czech Republic and Slovak Republic*, Paris, OECD.

OECD (1996b) *Transition at the Local Level*, OECD, Paris.

OECD (1992) *Regional Development Problems and Policies in Poland*, Paris.

Pecar, J (1997) *Regionalni vidiki razvoja Slovenije s pourdarkom na financnih rezultatih poslovanja gospodarskih druzb v letu 1996*, st.4/letnik VI./1997, Institute for Macroeconomic Analysis and Development, Ljubljana

Polityka (1998a) *Zloty rusza w swiat*, 11 April.

Polityka (1998b) *Parada kieszeni. Bieguny bogactwa i biedy*, 16 May.

Polish SME Foundation (1998) 'Raport o stanie sektora malych i srednich przedsiebiorstw w Polsce w latach 1996-1997', Warszawa.

RCSS (1998) *Poland 1997-1998. The Economic Performance*, Government Centre for Strategic Studies, May.

Radej, B (Ed.) (1997 and 1998) *Slovenian Economic Mirror*, Vols III:7, III:8, III:9, III:10, III:11, IV:1, IV:2, Institute for Macroeconomic Analysis and Development, Ljubljana

Rheinisch-Westfälisches Institut für Wirtschaftsforschung and European Policies Research Centre (1997) *Preparation for the First Report on Economic and Social Cohesion: the impact on cohesion of EU enlargement*, Report to the European Commission, Volume I.

Riley, R and Tkocz, M (1998) Coal mining in Upper Silesia under communism and capitalism, *European Urban and Regional Studies*, Vol.5 (3).

Roberts, K, Kurzynowski, T and Jung, B (1997), Employers' Workforce Formation Practices, *Communist Economies & Economic Transformation*, Vol.9, No.1.

Robinson, A *et al* (1997) 'Hungary', *Financial Times Survey*, 9 December 1997

Rzeczpospolita (1998a) *Administracja. Co sie moze skomplikowac*, 19 May.

Rzeczpospolita (1998b) *Rynek zaskoczony*, 21 May.

Rzeczpospolita, (1998c) *Rynek. Najlepsze lata juz minely*, 1 July.

Schamp, E.W. (1994a) *Industrial transition in the post-socialist countries: geographical perspectives*, Paper presented at the Conference of the IGU Commission on the Organisation of Industrial Space, Budapest.

Schamp E W (1994b) *Die Bildung neuer grenzüberschreitender Regionen im östlichen Mitteleuropa - eine Einführung*, Goethe-Universität, Frankfurt/Main.

Sicherl, P and Kukar, S (1997) Situation and Prospects of Slovenia - National Report, in: Rheinisch-Westfälisches Institut für Wirtschaftsforschung and European Policies Research Centre (1997) *Preparation for the First Report on Economic and Social*

*Cohesion: the impact on cohesion of EU enlargement*, Report to the European Commission, Volume I.

Statisticka rocena (1996), *CSU*, Prague.

Stryjakiewicz, T and Kaczmarek, T (1997) *Transborder Co-operation and Development in the Conditions of Great Socio-Economic Disparities: the Case of the Polish-German Border Region*, Paper presented at the EURRN Conference, 20-23 September.

Surazka, W, Bucek, J, Malikova, L and Danek, P (1996) Towards regional government in Central Europe: territorial restructuring of post communist regimes, *Environment and Planning C: Government and Policy*, Vol. 14.

Surazka W (1995) Transition to democracy and metropolitan fragmentation', *The Journal of Political Geography,* No.15.

Task Force for Structural Policy (1997) *Poland's Structural Policy in the Perspective of European Union Integration,* Warsaw.

Transition (1998) *Accession to the EU- A Reform and Growth*, April.

Transition (1997) *Domestic Consumption Drives Economic Growth*, February.

Tucker, E (1997) 'Hungary plays by EU rules with steely determination', *Financial Times*, 7 May 1997

Tucker, A, Balharova, J, Losman, I, Nemec, J, Nemecek, J, Ondracka, D, Polak, Z, Skyva, R, Vyrkova, M and Zidkova, M (1997) The Czech Transition: Politics before Economics, *The Journal of Social Political and Economic Studies*, Vol. 22, No. 4.

Turnovec, F (Ed) (1997) *Czech Republic. Basic socio-economic indicators*, Centre for Economic Research and Graduate Education, Charles University, Prague.

United Nations (1996 and 1997) *Estonian Human Development Report*, United Nations Development Programme, Tallinn.

Unwin, T (1997) Agricultural Restructuring and Integrated Rural Development in Estonia, *Journal of Rural Studies*, Vol. 13, No. 1.

Vintrova, R (1994) *World Industry since 1960: Progress and Prospects*, UNIDO, Vienna.

World Economy Research Institute (1998) *Poland. International Economic Report*, Warsaw School of Economics, Warsaw.