Local Government
and Public Service
Reform Initiative

Investing in Regional Development:

Policies and Practices in EU Candidate Countries

Edited by

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Foreword

This book was prepared under the "Local Government Policy Partnership" Program, the joint project of two donor organizations. The British Government's Department for International Development (DFID) and the Local Government and Public Service Initiative (LGI), Open Society Institute, Budapest launched this regional program together. The "Local Government Policy Partnership" (LGPP) projects intend to contribute to policy development and innovation within these countries (http://lgi.osi.hu/lgpp/).

The LGPP hopes to develop expertise and support professional cooperation amongst local government specialists throughout Central and Eastern Europe. Parallel to this, the experiences gathered throughout the region should be made available in Central and Eastern Europe as well as in Central Asia. The core partner countries are the Czech Republic, Hungary, Poland and Slovakia. However, other countries have been invited to participate in these regional projects, in order to help facilitate direct information exchange and comparisons of policy efforts.

LGPP publications include policy studies and proposals that have been presented to government officials and experts in the countries involved. Targeted beneficiaries of LGPP projects are national government ministries, local government associations, research and training institutions and individual local authorities throughout the CEE region. LGPP intends to publish three studies a year.

In the first year of operation, the LGPP selected the following three policy areas for analysis: (i) education financing and management; (ii) regulation and competition of local utility services and (iii) public perception of local governments. The policy studies were widely disseminated in our region. They supported the policy dialogue (e.g., on education in Macedonia) and served as training materials (e.g., for regulatory experts).

Topics for the second year of LGPP (2001/2002) were rather different by nature:

a) decentralization and regional development;
b) the relationship between local government size, local democracy and local services delivery;
c) local government and housing.

This publication comprises the findings of the LGPP project, which has studied the local capital investment funding schemes and mechanisms in six candidate countries (Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania). These reports contain an inventory of the major flows of public finance for investment in infrastructure, business and labor market promotion. The studies focus on funding schemes with a regional dimension: European Union funds, transfers from state budget and off-budget funds, local government revenues, including municipal borrowing.

The basic purpose was to analyze how far these investments conform with the EU's regional development model and the related criteria of concentration, programming, subsidiarity, partnership, additionality and transparency. The authors investigated: (i) the relationship between the sectoral and regional allocation of investment resources and (ii) the respective roles of national, regional and local government in the allocation and management of regional development funds.

Kenneth Davey *Gábor Péteri*
June 2003

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PART I

Decentralization and Regional Development: The Rationale

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Decentralization and Regional Development: The Rationale

Kenneth Davey

1. INTRODUCTION

Negotiation and preparation for accession to the European Union (EU) have focused increasing attention on the interrelation between decentralization and regional development.

In several candidate countries reforms are in progress to complete or revise the process of decentralization commenced at the beginning of the 1990s. These reforms have three dimensions:

(1) The creation or revision of higher tiers of self-government at regional level;
(2) The devolution to regional or municipal government of responsibilities previously held by field offices of state administration;
(3) The enhancement of the fiscal capacities of self-government to strengthen local taxing power, take over operational funding of more local public services and accelerate investment.

Simultaneously, the pre-accession process has focused increased attention on investment in local public services and regional economic development. This is due partly to the prospective availability of pre-accession funding by the European Union and partly to the requirements to meet EU standards, particularly in the field of environmental protection.

2. EU POLICY

These two trends are fuelled by the importance given by the European Union to the roles of regional governments and partnerships, both intergovernmental and public/private, in the design and execution of development programs.

The EU's emphasis on regional development stems from the fear that a single market devoid of protectionist barriers will widen regional disparities. These in turn will threaten political, social and economic stability. Measures are needed to counteract these risks by strengthening the competitive capacity of poorer regions. Investment of "cohesion" funds is needed to "level the playing field."

There appear to be three reasons why the EU promotes the role of regional or local self-governments in allocating and managing these investments. Firstly, it ensures that they will be made in the target regions; it is much more difficult to determine the geographical use of money disbursed through sectoral ministry programs.

Secondly, developing regional capacity depends on integrating a variety of individual interventions; attracting private investment, for example, may require a mixture of infrastructural and environmental improvements as well as business support and labor force development.

Thirdly, regional and local governments are regarded as best placed to build up the intergovernmental and public/private partnerships necessary to development in a plural polity and market economy.

The implication of these concepts is that a major proportion of public investment should be targeted on less developed regions, channeled through integrated regional programs, and allocated and managed in partnership with regional and local governments and "economic and social partners" (i.e., private enterprise and NGOs).

3. NATIONAL RESPONSES: REGIONAL DISPARITIES

The reality of national situations in candidate countries falls short of this vision. In the first place there are tensions between *regional* and *sectoral* approaches to investment.

By regional investment we mean the allocation of resources for coordinated, multi-sectoral use in a given territory. The choice of territories to be covered and the overall distribution of resources between them would be largely determined by the objective of correcting inter-regional disparities in income and employment levels.

By *sectoral* investment we mean funding dedicated to a single sector and distributed by a sectoral ministry (or parallel government agency) at the national level.

The EU approach to regional development is concerned with the reduction in disparities, measured largely by differences in GDP per capita. The first objective is to raise below average incomes and all other objectives are concerned with contributory causes of low incomes, mainly related to changing employment. Interventions may be multi-sectoral, but they need to be integrated to achieve a common aim of generating greater income.

Much government investment, however, using both EU and other funding sources, is sectoral rather than regional by nature. It is concerned more with local disparities in individual public services from schools to sewerage. It lends itself to segmented programs driven by sectoral ministries. This sectoral approach is also encouraged by another dimension of accession, the requirements to meet EU standards and the financial support available from the Union in doing so.

Sectoral and regional allocation are not totally incompatible. Sectoral programs can be distributed to individual regions by competitive bidding. Regional economic and social priorities can be reflected in their allocation or in differential requirements for local contribution. They can be allocated and executed by sectoral ministries but within the context of French style regional planning contracts, involving agreement and complementary investment by regional governments. They can be executed by grants to regional/local governments who would decide on specific locations and uses within broad national specifications.

The financing of local government is also dichotomous in relation to the correction of disparities. State contributions to the operating costs of local government services are largely provided through tax shares or block grants that do not determine their end use. They are governed by normative formulae that also tend to incorporate some element of equalization of local revenues. The basic aim of such equalization is to reduce disparities in local public service standards. Of course, this type of equalization may well favor the less economically developed areas, but there is no exact fit. Territorial fragmentation may be just as responsible as economic differences for disparities in local tax bases and the lack of scale economies in service provision.

State contributions to regional/local government investment tend in contrast to be channeled through grants or direct expenditures that are sectorally dedicated. A normative basis of allocation is rare. Distribution may be based on service deficits, rates of return or outright patronage; it is rarely connected to regional economic disparities or to differences in local fiscal capacity. Some criteria, such as requirements for local matching, may have a dis-equalizing impact.

In practice, regional and local governments in CEE countries have financed much investment from their own resources, i.e., from a combination of operating surplus, borrowing and asset sales. However, their capacity to do so is generally declining for a variety of reasons and is in rough proportion to their economic prosperity, i.e., least in the poorer localities.

4. NATIONAL RESPONSES: DECENTRALIZATION AND PARTNERSHIP

It is by no means clear in practice that self-government is the chosen instrument for achieving regional participation and partnership in the design and management of regional development programs. In Hungary, for example, a set of development councils has been established at regional and county levels, in which self-governments are represented but not dominant players. In the Czech Republic and Slovakia, regional operational programs (ROPs) were compiled with the participation of regional state offices and *ad hoc* "monitoring committees." Other parallel structures are represented by the proliferation of regional development agencies.

These *ad hoc* measures in the Czech Republic and Slovakia were to some extent due to the absence of regional self-governments at the time ROPs had to be compiled. Nevertheless the fact that upper tiers of self-government may not equate with NUTS II regions and that they do not directly represent "social and economic partners" may continue to give governments an excuse for diluting their coordinating and management role in regional development.

Above all the influence of a fiercely competitive political environment has to be recognized. Most CEE governments are coalitions in which sectoral ministries cannot be coerced into surrendering power and resources to regionally determined and managed programs. Governments collectively may also be reluctant to vest discretion in regional governments that may well be controlled by opposition parties.

5. POLICY AND RESEARCH ISSUES

This analysis leads to two major conclusions. In a pluralist political environment constant tension and competition must be expected between:

(1) Sectoral and regional approaches to investment,
(2) Central, regional and local government agencies over the control of investment plans and resources.

The research summarized in this volume has looked at the actual funding of capital investment in six candidate countries—Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania—from two related perspectives:

(1) The balance and relationship between the sectoral and regional allocation of investment resources.
(2) The respective roles of national, regional and local government, in the allocation and management of regional development funds.

The research is concerned with public investment in projects that are regional or local in terms of their location and impact. The basic purpose is to see how far this investment conforms to the EU's regional development model and the related criteria of concentration, programming, subsidiarity, partnership, additionality and transparency. The experience is used to assess the real significance of regional policy, regional government and regional development planning in investment. How feasible are the aims outlined in paragraph nine that "a major proportion of public investment should be targeted on less developed regions, channeled through integrated regional programs, and allocated and managed in partnership with regional and local governments and 'economic and social partners' (i.e., private enterprise and NGOs)." How might this model evolve in practice?

6. THE COUNTRY REPORTS

The full report from each of the six countries is contained in the attached Compact Disk, and summarized in the following chapters. Each report analyzes current flows of investment finance to regional development and local public services. It describes briefly the public administration system and the divisions of responsibility between national, regional and local levels for functions relevant to regional and local development, outlining any major changes in progress or planned. It also outlines such regional policy as may have been developed and any changes over time, describing any significant disparities between regions and the terms in which they are understood and addressed by regional policy, as well as mentioning any significant changes over the last decade.

The reports then contain an inventory of the major flows of public finance which have, or should have, a regional dimension for investment in:

- Infrastructure,
- Business promotion,
- Human resource development (for labor market promotion only).

These are categorized by the following sources:

- European Union,
- State Budget,
- Off-Budget Funds,
- Local Government Revenues,
- Local Government Borrowing.

The inventories describe the approximate volume of these funds, the criteria and procedures used in distribution.

Each flow of funds described (whether from the EU or other sources) is evaluated in terms of its conformity with the following criteria:

(1) *Concentration:* i.e., the priority given in its distribution to the correction of inter-regional disparities;
(2) *Programming:* compatibility with coordinated multi-sectoral development strategies;
(3) *Partnership:* between levels of government and socio-economic partners in identification, design and implementation, and linked to subsidiarity, the assignment of responsibilities to the lowest efficient level;
(4) *Additionality:* co-financing between levels of government, socio-economic partners and/or final beneficiaries;
(5) *Transparency:* of criteria and procedures for allocation.

This evaluation is factual rather than judgmental. It is not assumed, for example, that priority in public investment should always be given to correction of inter-regional disparities or that all investment should require partnership or additionality.

7. CONCLUSIONS

The findings of the research are summarized in the final chapter, which attempts to reach conclusions about the current and potential significance of regional government, regional policy and regional development planning in the overall investment process.

Country Executive Summaries

Czech Republic

Jiří Blažek, Jan Přikryl, Tomáš Nejdl

Hungary

Károly Jókay, Zoltán Kristóf, Gábor Szepesi

Latvia

Mudite Priede, Agita Strazda

Lithuania

Gediminas Kuliesis, Vitalis Nakrosis,
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Poland

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Romania

Afrodita Popa

Capital Investment Funding in the Czech Republic

Jiří Blažek
Jan Přikryl
Tomáš Nejdl

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Capital Investment Funding in the Czech Republic

Executive Summary

Jiří Blažek, Jan Přikryl, Tomáš Nejdl

INTRODUCTION

This executive summary provides the main findings on the current state of regional development and policy in the Czech Republic, including the key issues of local and regional administration and especially conclusions and policy implications based on extensive analysis of existing support programs that are potentially eligible for assistance via the EU.

1. KEY PROBLEMS OF LOCAL DEVELOPMENT

1.1 Horizontal Fragmentation of Local Government

Several features specific to the Czech Republic have affected development at the local level. Prominent among these is a very fragmented settlement system. The communist regime responded to the huge horizontal fragmentation of the settlement system and of local government with a rigid policy of forced amalgamation of municipalities. Under the communist system of central planning, the amalgamation endangered the very existence of small villages for it was almost impossible to obtain any resources (administered centrally) for investment or other projects in small, amalgamated villages. Even the construction of family houses was discouraged by the state in these villages. Consequently, under communism, the process of amalgamation was extremely unpopular; the municipalities concerned tried to delay the whole process as much as possible.

Therefore, in the Czech Republic, the number of municipalities decreased from 11,000 in 1948 to only 4,100 in 1989. In addition, for the reasons described above, when democracy was reintroduced at the local level after 1989, many amalgamated municipalities decided, on the basis of local referenda, to split-up and to re-establish the local government in their villages. This movement, mirroring the revival of local communities, was quite overwhelming; more than 2,000 municipalities were re-established within the first two to three years of transition, thus increasing the number of municipalities by about 50% to approximately 6,200. The number of municipalities now appears to have stabilized (see Table 2.1).

The 1990 decision to abolish the regional level of administration (consisting of eight regions) also had important implications for local development. This measure was taken mostly for political reasons, especially to destroy the communist hierarchical system. At the same time, it was decided to leave only the functions of the state administration at the district level. Consequently, a significant re-allocation of responsibilities had to take place. Some responsibilities (especially from the regions) were transferred to the bodies of central administration while others were assigned to the districts or even to municipalities.

Table 2.1
Territorial Structure of Public Administration in the Czech Republic

Year	Number of Municipalities	Number of Districts	Number of Regions
1989	4,231	76[1]	8
1999	6,234	77	0
2001	6,258	77	14[2]

SOURCE: *Czech Statistical Office, The Constitution of the Czech Republic.*

The huge territorial fragmentation of local government and the abolition of regions have many important implications for the relations between the state administration and local government, as well as for the design of the system of local government financing. The large number of small municipalities has caused two principal problems since the beginning of the transition. The first problem was the acute investment needs of re-established municipalities of a small size. This problem was caused by the restricted possibilities for investment under communism, on the one hand, and the very limited size of their budgets, on the other.

The second problem is connected with small municipalities' limited human resources. The shortage of capable personnel was exacerbated by swiftly changing legislation during the period of transition. Many small villages do not even have sufficient personnel to read the new pieces of legislation, let alone implement them properly. This situation significantly limits the capability of many small municipalities to take on additional competencies. To solve some of these problems, a network of about 380 larger municipalities has been formed. These municipalities were delegated various additional tasks that they also perform for other smaller municipalities. Although horizontal fragmentation is causing many day-to-day problems, the flip side of the coin is that citizens have an enhanced interest in the local affairs of their villages.

1.2 Reform of Public Administration at Regional Level

The reform of public administration at the regional level has proved to be the most difficult of all the levels of public administration. The reform started in 1990 by abolishing eight regions and leaving only state administration at the district level. The rationale was to cut the mutual ties of the former nomenclatura cadres and to decrease bureaucracy.

However, the absence of any self-government bodies between the municipal and the state level caused many practical problems, such as the lack of an institution responsible for managing services and dealing with issues above the municipal level. Moreover, the central ministries faced difficulties in executing their tasks and therefore set up a network of regional branches, so called "deconcentrated offices." The establishment of these regional branches was uncoordinated; consequently, nearly all ministries designed their own network of regional branches.

In addition, neither citizens nor politicians perceived the issue of regional administration as a priority. This situation changed after the 1996 elections when the center-right coalition lost its majority in parliament and had to change its policies and make concessions in order to retain its power as a minority government. In 1997 parliament approved a constitutional law stating that from 2000 the Czech Republic will consist of fourteen self-governing regions. However, the preparation of the whole package of more specific acts defining the competence and financing of new regions has been delayed. Therefore, the creation of regions was postponed by one year to January 2001.

2. RE-ESTABLISHING FISCAL AUTONOMY

2.1 Solving the Dilemma between the Principles of Solidarity and Meritocracy

Two important components of the re-establishment of the democratic system at the local level were restitution of municipal property (the vast majority of which had been owned by the state) and re-establishment of local financial autonomy. The problem of financial autonomy proved to be especially difficult to solve. The design of the new financial system of Czech local governments can be described as a "trial and error" approach. At least four different systems can be identified in the period from 1990 to the present (see Blažek, 1996).

The first period was 1990–1992. Because of a general mistrust of the central redistribution of resources under communism, there was strong pressure from newly elected local representatives to decentralize part of the tax system. However, in the first years of the transition a radical transfer of competences was carried out. The transfer of competences had to be accompanied by a transfer of financial resources for local authorities to perform these tasks. This was often done in the form of general or special grants. Therefore, until 1992, the main financial resources (about 70% of the total) of local government were received in the form of grants.

Table 2.2
Main Reforms of the System of Local Government Finances

System between 1993–1995	System between 1996–2000	System 2001
100% of revenues from personal income tax paid by employees working in the particular district, of which 45% allocated to particular district office and 55% distributed among municipalities within particular district according to per capita principle	60% of revenues from personal income tax paid by employees working in the particular district, of which 30% allocated to particular district office, 20% distributed among municipalities within particular district according to per capita principle and 10% allocated to municipality according to working place of employees	20.52% share on national revenues of VAT, on business tax, on personal income tax paid by employees and on personal income tax paid by small entrepreneurs distributed according to per capita principle[3]
100% of revenues from personal income tax paid by small entrepreneurs allocated to municipality according to permanent living place of the entrepreneur	100% of revenues from personal income tax paid by small entrepreneurs allocated to municipality according to permanent living place of the entrepreneur	30% of revenues from personal income tax paid by small entrepreneurs living in municipal territory
—	20% of revenues from business tax, allocated to all Czech municipalities equally according to per capita principle	Transformed into shared taxes (see above)
100% of property tax	100% of property tax	100% of property tax
other income: local fees, loans, etc.	other income: local fees, loans, etc.	other income: local fees, loans, etc.
territorial equalization grant (general grant)	territorial equalization grant (general grant)	abolished
special grants	special grants	special grants

Source: Acts on State Budget of the Czech Republic in 1995, 1996, 2000.

In 1993 a radical reform of local government financing was executed to increase the percentage of revenues that local government generated from their own sources. The core of the reform was that revenues from personal income tax were allocated to local government. At the same time grants were cut correspondingly. The system was rather complex (see Table 2.2), with a strong equalization mechanism operating among the municipalities within the districts on a per capita principle. On the other hand, among the districts, there was a rather modest equalization mechanism, the relatively small "territorial equalization grant" (amounting to about 2% of local budgets).

The third identifiable period began with the reform of 1996 and lasted until 2000. The main element of the 1996 reform was the replacement of 40% of revenues from swiftly growing personal income tax with 20% of stagnating revenues from business tax. At the same time the allocation criteria among the municipalities were changed (see Table 2.2).

The impact of the system introduced in 1996 has been multi-faceted. The most important change was the weakening of strong equalization mechanisms operating among the municipalities within the particular districts and introduction of relatively strong equalization mechanism at the inter-district level. Therefore, since 1996, there have been equalization mechanisms both within and among the districts. The biggest losers were the large cities such as Prague or Ostrava, which lost 40% their revenues from personal income tax. Nevertheless, sizeable disparities in per capita revenues remained among the districts, and the central government therefore proposed yet another financial system for local government.

2.2 The 2001 Reform of Local Government Financing

The reform entered into effect in January 2001 and originally should have also allowed for the financing of fourteen new regions that were introduced at the same time. The substance of the new reform is an equal sharing of both parts of the personal income tax (paid by employees and by small entrepreneurs) and of part of the business tax and value added tax equally by all municipalities on a per capita basis. In addition, the municipalities were arranged into several categories according to their population size. Each category was assigned a coefficient reflecting the fact that larger municipalities and cities are also performing functions for outlying areas. However, due to the poorly prepared regional reform of public administration, this proved to be unrealistic and regions in 2001 were financed mostly by special grants. The new system is clearly over-stressing the solidarity principle over the principle of meritocracy and results in an extensive redistribution of sources while providing little incentives for local initiative.

Since the beginning of the transition, the development of the system of financing for Czech local governments has been far from straightforward. The main reason for the frequent changes in the system is the lack of a broad agreement between the central government and representatives of local government on the basic principles of the system's design. The latest proposal shows that the rules are not yet stable and not likely to be in the near future. The considerable instability of the system of local government financing can be stated as one of its principle shortcomings.

2.3 Capital Expenditures of Local Government

Municipalities are much more important investors than would follow from their share of GDP or public expenditures. While their share of GDP permanently oscillates between 8 and 10% (see Table 2.3), total investment has never been lower than 15% since 1993.

Table 2.3

Public Budgets as a Percent of GDP

Public Budgets	1993	1994	1995	1996	1997	1998	1999	2000	2001
State budget	34.49	33.08	30.96	29.86	30.21	30.31	31.48	35.81	33.83
Local budget	8.94	9.67	9.54	10.80	9.02	8.78	9.42	9.79	8.33
Total	43.43	42.75	40.50	40.66	39.23	39.09	40.90	45.60	42.16

Source: Ministry of Finance of the Czech Republic.

The role of municipalities in investment activity within the public sector alone is even more important. Although the size of local government budgets as a percentage of total public budgets has been decreasing since 1996, their share of investments from the public sector is growing slightly (see Table 2.4). The ratio of financial resources allocated to investment in municipal budgets is twice or even three times higher than that of the state budget (see Table 2.5). The share of investments in local budgets fluctuates around 30% while in the case of the state budgets the share is between 10–15%. Consequently, investments made by municipalities represent about *40% of public investments* in the Czech Republic.

Table 2.4

The Share of Local Government in Public Budgets [%]

Public Budgets	1993	1994	1995	1996	1997	1998	1999	2000	2001
State budget	79.41	77.39	76.44	73.45	77.01	77.52	76.96	78.53	80.25
Local budget	20.59	22.61	23.56	26.55	22.99	22.48	23.04	21.47	19.75
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Ministry of Finance of the Czech Republic.

Table 2.5
Local Government Capital Investment Compared to Total Spending [%]

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Capital investment	28.46	29.64	31.26	25.72	28.91	27.06	26.38	33.15	29.14

Source: Ministry of Finance of the Czech Republic.

The principal reason why local government capital investment within the public sector is so important lies in the way the competencies were assigned among the different levels of public sector. Local governments are responsible for capital-intensive investment areas such as water systems, sewage and sewerage systems, local roads and school buildings. At the same time, the municipalities are battling against the huge internal debts racked up by these investment areas under communism. Moreover, local representatives are exposed to considerable pressure from local inhabitants and businesses to solve fundamental problems hindering local development and improvement of the general standard of living.

Both these pressures (i.e., delegation of costly responsibilities from the central government and pressure from local subjects) result in a situation where municipalities allocate approximately double their revenues for investment.

However, there is also a negative side to this largely positive trend. This is the high dependency of municipal investment activities on state financial assistance. According to a survey performed by the Ministry of Finance in 1997, state grants covered 25.5% of municipal capital expenditures and state interest free loans another 5.1%. It can be expected that this situation, where state transfers cover a third of municipal expenditures, will continue. It is clear that a large proportion of these investments would not be implemented without such state support. Due to the considerable instability of the state support policy (which is guided by annual state budgets) municipalities are forced to adjust their investment priorities according to the focus of state support programs. This situation boosts investment activity as municipalities are forced to use the opportunity even if local representatives do not deem the investment essential. At the same time this phenomenon contributes to an increase in municipal debt. Finally, another weakness of such a model is that it contributes towards the creation of a mentality of dependency on the state and leads to the temptation to solve infrastructural deficits with cheap (subsidized) grants instead of expensive (non-subsidized) maintenance and repairs.

The survey also showed that commercial loans covered 17% of capital expenditures made by municipalities. Therefore, municipalities covered only 52.4% of their capital investments from their own resources. Inevitably, these average figures vary according to the size of the municipality and other factors. However, in general, it can be concluded that the smaller the municipality is, the smaller its budget devoted to capital expenditures and the greater its dependence on transfers from state budget and state funds.

2.4 Financing of Self-governing Regions

In April 2000 parliament passed Act 128/2000, which enacted the establishment of fourteen self-governing regions. An attempt to endow the new regions with their own stable income base over which the elected regional bodies could exert their discretion failed—partly due to the fact that competences in the sphere of public sector provision and regional policy were transferred to the regions only during 2001. Therefore, it was difficult to specify exactly the level of required financial resources. As a consequence, both in 2001 and 2002, the financing of the regions proceeded only according to a temporary model in the form of the Act on Budgetary Allocation of Tax Revenues, which is annually adjusted. According to this Act for 2001, no own revenues were assigned to the regions. Consequently, the regions have been fully dependent on state specific grants.

As far as 2002 is concerned, the regions were allocated 2.52% of personal income tax (with the exception of personal income tax paid by small entrepreneurs) and the revenues of individual regions correspond to their population. The regions were also given 10% of revenues from the personal income tax paid by small entrepreneurs within the region but special coefficients were applied to mitigate differences between rich and poor regions. Despite these changes, the regions will remain at least 80% dependent on state specific grants even in the year 2002. The very low volume of own revenues hinders not only a significant own support policy but also limits their possibilities to participate in state support programs that require co-financing by final beneficiaries. Moreover, a weakness of the existing system of financing is the excessive stress on equalization.

3. DEVELOPMENT OF REGIONAL DISPARITIES AND POLICY

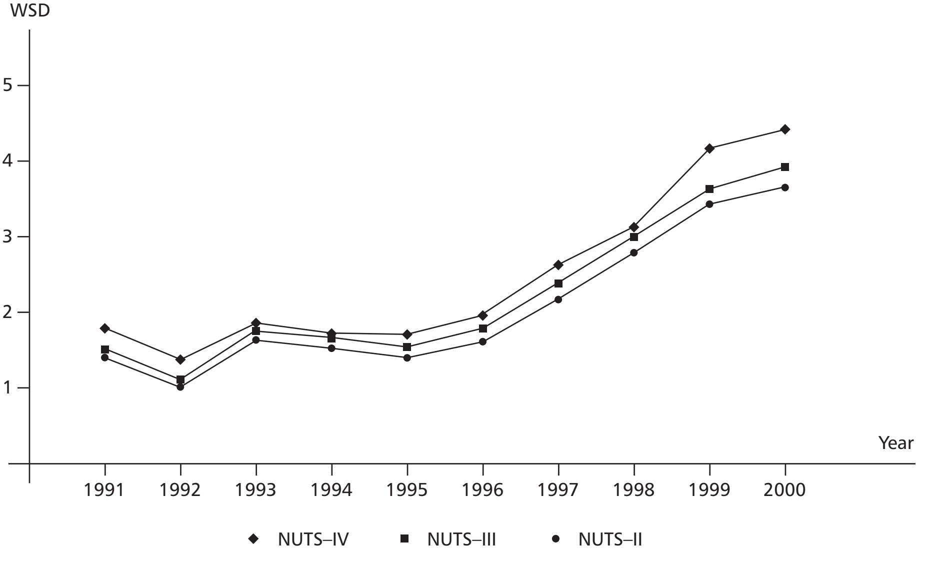
3.1 Development of Regional Disparities during Transition

The Czech Republic entered the transformation period as a country with relatively minor inter-regional disparities. This was the result of the strong equalization policy pursued under communism. Equalization policy was quite effective but very inefficient and led towards the country overtly lagging behind West European countries in the sphere of societal development.

The general tendency of regional development in post-communist countries after the collapse of the system can be described as *differentiation.* Generally, diversified metro-politan regions have performed better than non-metropolitan, industrial and rural regions (Hampl, 1999). The inter-regional disparities developed owing to a whole complex of interconnected factors such as vertical and horizontal geographic position, economic structure, industrial and entrepreneurial tradition, educational structure, development of technical infrastructure and the state of environment (Blažek, 1999; Hampl, 1999).

Regional disparities have started to deepen profoundly since the mid-1990s. The rate of economic growth plummeted, even turning negative at one point, and the rate of unemployment more than doubled between December 1995 and December 1998 and in several districts reached levels of serious concern (over 20% during 2000). In the EU, regional disparities are measured on the level of the NUTS II and NUTS III regions. (NUTS is the Nomenclature of Territorial Units for Statistics.) More specifically, the size of inter-regional disparities in the unemployment rate is most often measured by EUROSTAT by weighted standard deviation (WSD). The standard deviation is weighted by the size of the NUTS II regions—measured either by the number of economically active people or by the number of inhabitants.

Figure 2.1
Development of Inter-regional Disparities in the Czech Regions
NUTS II–IV Measured by Weighted Standard Deviation



Source: Blažek (2001).

After some fluctuations in the first half of 1990s, the graph illustrates a steep increase in inter-regional disparities since 1995. The scale of disparities depends obviously on the number of units (regions) used in analysis. Therefore, not surprisingly, the smallest disparities were found on the level of NUTS II regions (eight units) while the largest were found at the district level (77 units). However, given the large variance in the number of units on particular NUTS levels, the differences in disparities are surprisingly small.

Table 2.6

Regional Disparities in Unemployment According to NUTS II Regions in the EU Countries (1999) and in the Czech Republic (2000)

Country	Rate of Unemployment [%]	Weighted Standard Deviation	Coefficient of Variation [%]	Number of NUTS II Regions
Austria	4.0	1.1	27.5	9
Belgium	8.8	4.3	48.9	11
Finland	11.5	3.2	27.8	6
France[4]	11.4	2.5	21.9	22
Great Britain	6.1	2.6	42.6	35
Germany	8.9	4.3	48.3	38
Greece	11.7	2.0	17.1	13
Italy	11.7	7.9	67.5	20
Netherlands	3.3	0.8	24.2	12
Portugal	4.7	1.4	29.8	7
Spain	16.1	5.7	35.4	18
Sweden	7.6	1.6	21.0	8
Czech Republic	8.8	3.7	41.4	8

SOURCE: The data on the EU countries were published in the *2nd Report on the Economic and Social Cohesion*, Volume 2, Statistical Annex, European Commission, Brussels, 2001; rate of unemployment for The Czech Republic—The Ministry of Labor, own calculation of measures of variation for the Czech Republic.

NOTE: Ireland, Denmark and Luxembourg are not shown in the table as their territory consists of a small number of NUTS II regions.

Despite the fact that the Czech Republic ranks in comparison with many of the smaller EU countries, it cannot be stated that the inter-regional disparities within the Czech Republic are negligible. Of the EU countries of relatively comparable size only Belgium has more profound regional disparities than the Czech Republic. On the other hand, the Czech Republic does not suffer from such huge regional problems like some other transforming countries (e.g., Upper Silesia in Poland or the polarity between Budapest and the mostly rural rest of Hungary).

3.2 Formation of Czech Regional Policy

Despite some recent progress, the Czech Republic is still missing comprehensive and efficient regional policy. In the first half of the 1990s regional policy was only a very low priority and has only gained more attention recently.

Regional policy until 1996

In the Czech Republic the development of regional policy can be divided into three periods during the transition. The first period lasted between 1991–1992. During this period, the aims of regional policy were quite ambitious but no new programs were implemented in the regions. More important for future development was the second period (1992–1996) where the role of regional policy was intentionally marginalized. The reasons for this low profile approach by the Czech government were historical and geographical (small inter-regional disparities inherited from the former communist regime), economic (until 1996 an unnaturally low rate of unemployment of around 3 to 4%) and political (explicit one way liberalism and an unwillingness to intervene in the market). The official regional policy was very modest and consisted only of the offer of meager support to small and medium-size firms (in the form of soft loans) in assisted regions selected on the basis of the unemployment rate (i.e., higher than 5% in 1996).

Nevertheless, the Czech government gradually developed a whole array of policies with (intended or unintended) significant regional impacts. But these policies do not comprise a comprehensive approach to regional issues. Almost every ministry prepared some program with important regional impacts (Blažek, 1999). For example, at the beginning of the 1990s the government pursued (though not very frequently) the policy of "selective financial restructuralization" (i.e., writing off the debts from the communist period) of large companies whose collapse might seriously endanger regional labor markets. There are numerous other examples: the Ministry of the Environment distributes the resources from the Environment fund to projects aimed at improving the environment of the most polluted regions; the Ministry of Transport supports public transport in rural areas; the Ministry of Agriculture supports farmers in less favorable situations or in environmentally protected areas; the Ministry of Labor allocates funds for active employment policy to district job centers in areas of high unemployment; the Ministry of Trade and Industry supports small and medium-size firms and foreign investors through regional partners of the agency CzechInvest.

The main weakness of this approach lies in its institutional fragmentation and lack of horizontal coordination at the governmental level. Until 2000, this problem had been exacerbated by the lack of regional self-government, which would, had it existed, have played an important coordination role.

The third (current) period of Czech regional policy

In the mid-1990s there were two main stimuli to the development of a more integrated approach toward regional policy. Firstly, the internal conditions changed significantly, especially the growth in unemployment and the sharpening of regional disparities, and politically there was a significant retreat from neo-liberalism. Secondly, an important stimulus came from pressure exerted by the EU, for which economic and social cohesion is a high priority (consuming about a third of the EU budget). Moreover, the EU also conditioned the provision of support via pre-accession programs through the efforts of County Councils (CCs) including an increase in the efficiency of the public sector and the design of modern regional policy. Finally, the EU closely observes the overall developments in CCs and the findings are published annually. All the above contributed to the fact that the Czech government has recently taken several important measures in the area of regional policy.

The Ministry for Regional Development and Center for Regional Development were established in 1996 to promote regional development. Originally, the intention was to shift implementation of the most important sectoral programs with important regional dimensions into this ministry, but this has happened only in one case—the Program of Revitalization of the Countryside was transferred from the Ministry of Agriculture. Concerning legislation, the Regional Development Act was passed by parliament in 2000 (No. 248/2000). The Act defines the responsibilities not only with respect to Czech regional policy but also in preparation and future implementation of EU cohesion policy. In the area of programming, the government approved for the first time the strategy of regional development in the Czech Republic in 2000. This should guarantee a more efficient design of Czech regional policy. With respect to support programs, in addition to the regional support to SMEs, state regional support programs were approved by the government for the two most troubled regions (NUTS II Northwest and Ostravsko). These programs provide support to municipalities in the regions in question in several areas, but mainly in the sphere of infrastructure and specifically business infrastructure such as industrial zones. Consequently, financing allocated to regional policy has increased significantly.

Significant effort is also devoted to preparation for the EU cohesion policy and to implementation of the pre-accession programs. In order to prepare for implementation of pre-accession support from the EU, completely new institutional structures were formed. The most important is the National Management and Coordinating Committee chaired by the Ministry for Regional Development and charged with overall coordination of the pre-accession structural aid.

Despite recently achieving significant progress, Czech regional policy still departs considerably from the EU cohesion policy. A comparison of the main differences between these policies is shown in Table 2.7.

Table 2.7
The Main Differences between Czech Regional Policy and EU Cohesion Policy

Sphere	Czech Regional Policy	EU Cohesion Policy	Remark
Programming	CR until recently without programming documents, now *over-programming* (two sets of programming documents—one for Czech RP the other for EU cohesion policy), standard programs, low invention, top-down motivation for drafting programming documents; however, recently some progress	Already the third generation of programming documents	Excessive emphasis on analysis, weak strategic component, no consideration of alternatives
Implementation structure	Prevailing sectoral approach	Different systems	
Integrity of approach	Narrow conception of RP and its insufficient coordination with other policies	Integrated multi-sectoral approach	Progress recently, esp. regionalization of sectoral policies and implementation of more integrated state support programs for effected regions
Incentives of RP	Limited spectrum of incentives used	Wide spectrum of incentives	Regional Development Act is consistent with the EU principles
Size of projects	Small projects prevailing	Prevailing large projects	
Selection of projects	Problems with transparency	Clear separation of management, monitoring and control function.	
Evaluation of efficiency and effectiveness	Weak tradition, performed infrequently and ad hoc	Systematic attention and pressure for further enhancement	Chance posed by preparation of the Monitoring System for Structural Funds (MSSF).

Table 2.7 (continued)
The Main Differences between Czech Regional Policy and EU Cohesion Policy

Sphere	Czech Regional Policy	EU Cohesion Policy	Remark
Partnership	Weak tradition, esp. in the case of projects on supra-municipal level	Different practice	
Involvement of private sector	Low participation of private sector in preparation for and limited awareness about cohesion policy	Strong role, often significant initiative	
Public administration	Huge instability (fourteen new regions, planned dissolution of districts and creation of smaller districts in 2003, large horizontal fragmentation of local government and unprecedented instability of their financing	Different systems	Serious disadvantage given large expected role of regions, towns and municipalities
Volume of financial resources	Small but increasing	Many times higher	

SOURCE: Blažek (2001).

Probably the biggest enduring problems in Czech regional policy are coordination of regional development measures and programs. When an acute crisis develops in one of the regions, the assistance is usually *ad hoc*. Therefore, a sectoral approach to regional problems still prevails.

4. ECONOMIC AND SOCIAL COHESION POLICY: METHODOLOGY AND DEFINITIONS

The methodology used for gathering relevant information was based on an analysis of the activities of key institutional subjects. Firstly, the activities performed within the responsibility of all relevant bodies of central administration and their affiliated or subordinated bodies were overviewed. Secondly, tables summarizing all relevant technical information about relevant programs or policies were developed (for details and tables see Annex). The tables also provide a specification of origin of financial resources: for example, state budget, off-budget funds, EU support, etc. Thirdly, on the basis of gathered information, an evaluation according to the principles of EU cohesion policy has been performed. Finally, the main observations about existing programs were summarized and some implications for possible future adjustments of existing programs and policies were derived. Unless otherwise stated, all data relate to the year 2000.

Table 2.8

Summary of the Structure of Support Programs
According to Priority Spheres of the EU Cohesion Policy

Sphere	Programs	Financial Resources [mil. EUR]		
		EU	State Budget	Off-Budget
Infrastructure (P1)	Industrial Zones Support		11.24	
	MRD Regional Support Programs I		9.75	
	Countryside Revitalization		16.19	
	CBC/PHARE Large Infrastructure Projects	17.1		
	Grants for Tourist Regions		0.62	
	Support of Housing		132.12	21.59
	Protection of the Environment			80.01
	Support of Renewable Resources of Energy			9.21
	Construction and Reconstruction of Water Related Infrastructure		39.88	
	State Fund for Transport Infrastructure			243.32
	Subtotal	17.1	209.8	354.13
		581.03		

Table 2.8 (continued)
Summary of the Structure of Support Programs
According to Priority Spheres of the EU Cohesion Policy

Sphere	Programs	Financial Resources [mil. EUR]		
		EU	State Budget	Off-Budget
Business Promotion (P2)	MIT Programs of the Support of SMEs	3.31	88.04	
	MIT Regional Business Support Programs (Start and reconstruction)		3.9	
	Support of Research and Development		6.34	
	Energy saving and the use of renewable resources		6.3	
	Support of Risk Capital (Fund for Risk Capital and Czech Venture Partners)	4.89		
	EU Programs for SMEs (Euro Info Correspondence Centers, Europartenariat, Interprise)	0.09	0.16	
	Support of Participation in Trade Fairs and Expositions and of the Support of Propagation Activities		4.7	
	MRD Programs of the Regional Support SMEs		10.93	
	MRD Regional Policy Programs II (RegioGuarantee, Region 2, Regional Support Programs for Industrial Enterprises in Northwest Bohemia and Ostrava regions)		17.36	
	SMEs Support Programs in the Sphere of Agriculture			28.72
	Subtotal	8.29	137.73	28.72
		174.74		

Table 2.8 (continued)
Summary of the Structure of Support Programs
According to Priority Spheres of the EU Cohesion Policy

Sphere	Programs	Financial Resources [mil. EUR]		
		EU	State Budget	Off-Budget
Human Resource Development (P3)	Support of Research and Development (Export, Centers, Stratech)		32.68	
	CBC/Phare Small Projects Fund	1.9		
	Active Employment Policy		97.77	
	Palmif	1.2	0.3	
	Development of Social Services		9.77	
	Subtotal	3.1	140.52	
		143.62		
Total		28.49	488.05	382.85
		899.39		

Note: Ministry of Culture programs were not included in the tables because of their specific character. Pre-structural instruments were not included in the tables as they began after 2000. Programs of support to non-productive functions of agriculture were not included.

5. EVALUATION

The tabular form provides a generalized evaluation of the main features of existing support programs according to the main principles of EU policy of economic and social cohesion (i.e., concentration, programming, partnership, additionality and transparency). Evaluation uses a scale of five grades where grade one indicates that a given criterion is hardly met whereas grade five indicates that a given criterion is fully met.

Table 2.9
Summary of the Evaluation of the Main Support Programs
According to the Principles of the EU Cohesion Policy

Type of Support	Program	Concentration	Programming	Partnership	Additionality	Transparency
Infrastructure	Support of Industrial Zones	2	4	4	4	3
	MRD support of development in selected regions	5	2	2	5	4
	Revitalization of countryside	5	4	3	5	3
	CBC Phare Large Projects	4	2	3	5	5
	Grants for Tourist Regions awarded by the Czech center of Tourism	1	1	2	4	4
	Construction of rental apartments and technical infrastructure	1	1	2	5	3
	Supporting construction of nursing homes	1	1	2	5	3
	Modernization of the housing fund	1	1	2	5	3
	Reconstruction of prefab housing	1	2	2	5	3
	Support for insulating private dwellings	1	2	2	5	3
	Environment support programs of SFE	3	3	3	3	5
	Support of investment projects for usage of renewable energy resources	1	1	2	3	5
	Transport Infrastructure support programs of SFTI	3	3	1	1	2
Pre-accession support programs	PHARE	5	5	1	4	3
	SAPARD	2	5	4	5	3
	ISPA	2	5	2	5	3

Table 2.9 (continued)
Summary of the Evaluation of the Main Support Programs According to the Principles of the EU Cohesion Policy

Type of Support	Program	Concentration	Programming	Partnership	Additionality	Transparency
Business Promotion	MIT programsfor SMEs	2	1	2	5	4
	MIT regional business support programs (Start, Rekonstrukce)	3	1	3	5	4
	Research and Development SUPPORT PROGRAMS of MIT (Technos, Park)	1	1	3	4	5
	Support of energy saving	1	4	4	4	3
	Support of Risk Capital (Fund for Risk Capital and Czech Venture Partners)	1	1	4	5	5
	EU programs for SMEs (Euro Info, Interprise, Crafts, Distibutive Trade)	1	1	4	4	5
	Support of participation in trade fairs and of the support of propagation activities	1	4	3	4	5
	MRD programs for the regional support of SMEs (Region, Vesnice, Regenerace, Preference, Provoz, Hranice)	5	1	4	4	3
	Agriculture Support programs (Investice, Mládí, Export)	2	2	1	3	3
	Preservation and renewal of cultural heritage	3	3	1	3	3
Human Resource Development	Research and Development support programs of MIT (Export, Centers, Stratech)	1	1	3	4	5
	CBC Phare Small Projects Fund	4	2	3	5	5
	AEP (active employment policy)	4	4	1	3	5
	Palmif (Pro-active Labor Market Intervention Fund)	4	4	3	3	5
	Development of social services	1	4	4	3	5

NOTE: Five points represents high compatibility with the EU principles of policy of economic and social cohesion, one point represents the lowest score.

6. CONCLUSIONS AND POLICY IMPLICATIONS

An extensive set of support programs that are implemented by the central bodies of state administration towards both the public and private sector covers relatively evenly all three priority pillars of EU cohesion policy, i.e., development of infrastructure and investment in the environment, human resource development and business support. Therefore, from this point of view, the set of support programs is elaborate and balanced. In total, the volume of financial resources is massive and amounts to several dozen billion CZK (EUR billion).

Despite the sophisticated nature of support programs and the sizeable amount of financial resources, the package of support programs suffers from several serious weaknesses, which radically reduce their effectiveness and efficiency. In the case of the municipalities, the basic weakness is the instability of their financing system. Frequent and radical reforms of the system of local government financing (and therefore also significantly reduced predictability of revenues in the future) limit the possibilities of municipalities to participate in different support programs. As a consequence, participation in state support programs that as a rule require co-financing from municipalities becomes relatively risky ventures. On the one hand, this lowers the interest of municipalities in submitting project proposals; on the other hand, it contributes towards the growth in municipal debt (a sizeable proportion of municipal debt represents financial obligations connected with drawing resources from state support programs). This weakness is compounded by the fact that a majority of municipal projects are implemented from the resources provided by the state budget on an annual basis and consequently these resources have to be allocated, committed and administered into the accounting system within the year. The financing of funds operating on a multi-annual basis is rather an exception.

As far as support programs for entrepreneurs are concerned, the principal weaknesses are insufficient impact and a cumbersome administrative procedure. Both these weaknesses are closely connected with the fundamental shortcoming of the support programs in general, which is their enormous fragmentation. In the Czech Republic public support is provided via several hundred programs and sub-programs, which as a rule suffer from insufficient financial resources and require different criteria to be met for each individual program.

Excessive fragmentation of support programs thus drastically increases the administrative costs of implementing these programs, especially projects' planning, evaluation, selection and contracting. This, in turn, increases the costs of financial and physical controls. The high costs of administration squeeze not only support programs' promotion expenditures among potential beneficiaries, but also the amount of resources allocated to supported projects themselves. Another negative aspect caused by extreme fragmentation is the complex and unclear nature of the whole system of support programs. This hinders access to these programs particularly to small and medium-size enterprises (SMEs). For SMEs it is difficult to find out what kind of support programs are on offer, and more notably, difficult to acquire the specific knowledge needed for project application and implementation.

A key source of problems with coordination is the lack of application of the principle of programming for evaluation of social and economic relevance and effectiveness of support schemes. In the same vein, the support programs are only very exceptionally tied to corresponding sectoral strategies. The condition of a proposed project to be included in local or regional development strategy is in fact applied only in a single support program financed by the Czech financial sources, the countryside revitalization program. However, it should be stressed that over the last two years a significant improvement in this sphere has been recorded, and as a rule relevant sectors have approved strategic programming documents, though even now the situation is far from ideal. Frequent weaknesses observed in programming documents are their limited mutual consistency, a tendency to overlap together with a somewhat formal approach towards their drafting that stifles invention.

Owing to the limited coordination of supported projects via the principle of programming, the principle of partnership is also often executed only in a formal sense. The same criticism concerns the issue of transparency; a clear and equal approach towards all subjects is supposedly applied, but in practice there is a huge overhang of demand over supply due to limited financial resources allocated to individual support schemes.

A solution to all these shortcomings is possible only by a radical reduction of the number of support programs, which should be formulated more broadly and should correspond to priorities defined by corresponding national and regional strategic documents.

A possible impetus for such a radical restructuring of state support programs, especially those aimed at supporting final beneficiaries of decentralized bodies of public administration, might stem from the newly introduced regional self-governments. It is likely that after solving the fundamental problem of their very existence, the representatives of new regions would expect that the state would decentralize responsibility over at least some support programs. Moreover, the government itself is becoming more and more aware of excessive fragmentation of its support programs, and therefore recently decided to shift all responsibilities for support to SMEs to one ministry (the Ministry of Trade and Industry). This indicates that the role of this ministry is rather weak and even opposition politicians feel that after the parliamentary elections this ministry might be abolished. This would inevitably cause changes in the package of support programs administered by the ministry both in the sense of their number and focus and procedural matters.

Nevertheless, the outcomes of all these factors and different interests is difficult to assess as there are permanent attempts from varying pressure groups to establish new support programs. Consequently, it is unlikely that a radical change in the system of support programs would be accepted; more likely is a gradual modification of a package of support programs.

Looming EU accession is also having immediate effects on the reorientation of Czech regional policy. More specifically, EU accession would see Czech regional policy come under the authority of the EU itself. The task of national regional policy should be primarily to eliminate the leverage effect of support from the Structural Funds (SFs) in the form of matching grants, as poorer regions would not be able to provide sufficient financial resources for co-financing eligible projects. Therefore, Czech regional policy might provide, for example, an additional 15% of the cost of co-financing projects implemented in the most needy regions.

In much the same way, towns and municipalities should already pay special attention to healthy financial management as large debts might prevent them from access to the generally very favorable support offered from the SFs. The municipal debt represents not only danger for the stability of public finances. After accession (and to some extent even now) the CCs will be obliged to proceed towards the convergence criteria defined by the Maastricht Treaty. Sound financial management of municipalities is especially relevant given their expected prominent role in the future co-financing of SF programs (municipalities allocate more financial resources to investment projects than the state itself).

The reorientation of national regional policy towards the EU cohesion policy would also require a change in its time horizon from the current annual programs to a multi-annual approach. The Czech Republic also lacks the evaluation culture necessary to guarantee effective and efficient use of public sources. This is true of both specific regional policy and the public sector in general. Furthermore, along with the mostly technical changes in national regional policy there are also more conceptual questions that must be clarified.

One of the big challenges facing CCs is a gradual switch from low-road to high-road strategy of competitiveness (see also Porter, 1999). The current advantage of low costs does not offer a sound basis for catching up with West European countries. Therefore, for example, the current emphasis of state policy for inward investors should refocus from traditional investment incentives to after-care programs aiming at maximizing the effects of existing foreign investments. Also, emphasis should be placed on shifting the structure of investment towards the more sophisticated, higher added value industries. The goal should not be an immediate rush to open high-tech industries but medium-tech would be a good start (e.g., customer service centers for software producers, or the opening of local offices of international audit or consultancy firms). Secondly, from a regional point of view, it would be desirable to promote less uneven spatial distribution of FDI (foreign direct investment). Such a promotion would be best achieved by a combination of "hard measures" such as the provision of adequate infrastructure, and "soft measures" including territorial marketing.

However, perhaps the most significant change in the sphere of regional development and regional policy in comparison with the beginning of the transition is the existence of relatively mature entities, especially self-government bodies in larger towns, regional development agencies and others. However, the regional self-governments are only now learning how to play their role effectively and it will take time before they will fully establish themselves. Unfortunately, some of the Czech regions seem to replicate the main weakness of the support program—i.e., the huge fragmentation into smaller programs. Several of the fourteen self-governing regions are preparing their own tiny support schemes aimed mainly at supporting development of infrastructure by municipalities or tourism-related activities, partly to justify their significance or even very existence.

Currently, however, even the basic framework for the operation of new regions is not established. Competencies are unclear; moreover, additional transfers of competencies are being prepared and property transferred to the regions is saddled with huge internal debt. However, the most visible symbol of weakness of the new regions is their financing system. The regions are receiving by far the largest share of their incomes in the form of special grants for education (about 90% of their total incomes). The representatives of the regions are now fighting for a larger share of public budgets and the means to generate real sources of own revenues.

Therefore, in the future, the initiative and qualification of local and regional representatives will thus become important factors in local and regional development. Of principal importance is the need to shift priorities in regional development strategies from the current stress on technical infrastructure towards business support (now starting but mostly limited to building industrial zones) and especially towards the development of human resources (retraining, life-long learning, etc.), which remains an undiscovered area for most Czech municipalities. Investments into human resources would increase not only the competitiveness of domestic firms but also the attractiveness of the country for investors in the tertiary or quaternary sector or—within the secondary sector—in medium-tech and even high-tech industries. Obviously, this task is a challenge not only for the state but also for the municipalities, regions and private firms whose current interest in workforce education and research is insufficient. These changes would help the switch from a low-road to a high-road competitiveness strategy and thus help facilitate a real integration of the Czech Republic into the wider European economy.

ENDNOTES

[1] Until 1990, at the district level functioned bodies *elected* under communism. These representative bodies were abolished in autumn 1990. Since then, districts are performing only the tasks of state administration. These bodies of state administration are called *district offices*.

[2] Establishing fourteen regions was approved by constitutional law in 1997. The regions started to function in January 2001.

[3] Firstly, however, a 30% share of revenues is allocated to the municipality where the entrepreneur has a permanent address.

[4] All the data relating to France exclude the French overseas territories.

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Capital Investment Funding in Hungary

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Capital Investment Funding in Hungary

Executive Summary

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INTRODUCTION

The overall goal of this study is to serve as a basis of comparison between the capital investment support systems of other transition countries with a level of development similar to Hungary. The range of capital investment funding discussed in this paper is limited to infrastructure, business promotion and labor force development. The analysis, not all of which is summarized below, is divided into the following chapters:

- A short description of the Hungarian public administration system and model of self-governments/municipalities, with special regard to the allocation of development responsibilities at each level.
- A description of significant anomalies in development levels between certain Hungarian regions and the measurements used to identify and describe these anomalies.
- Inventory of financial resources with regional aspects, that is, funds and development resources flowing into the public sector, in the areas of infrastructure, business promotion and labor force development.

1. PUBLIC ADMINISTRATION AND REGIONAL DEVELOPMENT LAYERS

Public administration in Hungary is divided between state public administration and public administration performed by local government. Hungary has nineteen counties (NUTS III level—Nomenclature of Territorial Units for Statistics) and over 3,100 municipalities (NUTS V level). The NUTS II level is represented by seven regions. Beyond planning and coordination, regional officials have few functions. The NUTS IV level exists only as informal micro-regions and associations with no funds, self-government or administrative functions. Each municipality is equal before the law. There are two elected layers of governance: parliament and over 3,100 municipal assemblies.

Hungary's NUTS II level regions were created after nearly six years of intense debate that included options to turn Hungary into one NUTS II region together with general disagreement over the defining of inter-regional boundaries. Boundaries were not based upon demographic, economic or geographic fault lines but rather by political compromise; the nineteen counties were retained and added together to form regions. The next debate, naturally, centered on which "poorer" counties to include in the Central Region dominated by Budapest which exceeded 75% of the EU reference GDP per capita figure by the late 1990s.[1] Regions stretch laterally over diverse economic and geographic zones in an arbitrary manner. Moreover, existing county boundaries do not reflect economic, topographic or political conglomerations. Each county, with a capital city and perhaps a powerful "second city," then added to the debate over which city in each region should be considered as the headquarters for regional planning and organization. The outcome is that cities take turns providing headquarters, or county governments rotate the provision of the logistical and administrative support needed to conduct the limited tasks assigned to the Regional Development Councils. What the EU first proposed as a rational method of ensuring regional cooperation and investment resulted in seven distorted regions optimizing political and poverty considerations, rather than organic regional considerations. A section in the annex on regional disparities based upon the county and the NUTS II level regions, as units of comparison, will demonstrate the arbitrary and purely illustrative nature of these units.

1.1 Mismatch of Roles and EU Expectations

Two pieces of legislation guide regional development in Hungary, the 1996 and 1999 Acts on Regional Development. Regional development naturally includes the private, voluntary, non-profit and international sectors. However these laws, in addition to defining the NUTS II regions listed above, assign specific regional development roles (and allude to funding) for the following levels: national, regional, county and the micro-region. Regions have a partnership role in this system, while the NUTS IV level micro-regions only exist as voluntary associations created by the NUTS V level municipalities. Neither the NUTS II nor the NUTS IV levels considered critical by the EU pre- and post-accession funding sources have administrative or self-governing roles. Concurrently, the NUTS III level, counties, and the NUTS V level, municipalities, both of which possess democratic legitimacy and have true public administration functions, lack funding and authority to conduct capital investment for regional development. This political and economic tension has made it difficult for Hungary to organize its SAPARD offices and to develop the skills and institutions needed to eventually compete with successful EU regional grant applicants such as Ireland (one NUTS II region), Catalonia and Alsace.

1.2 Hungary's Regional Development Dilemma

Those organizations with the greatest democratic legitimacy and citizen involvement have the least authority and certainly no own sources of funds with which to conduct regional development. Conversely, the National and Regional Development Councils and the County Regional Development Councils control funds for which municipalities and micro-regional associations, private businesses and NGOs have to compete. Ministries, national agencies and other authorities dominate the Regional Development Councils and the National Regional Development Council and may decide over the allocation of funds and supervise their use, while micro-regions, led by municipalities, are in a subordinate grant-seeking position even though their plans may reflect true cross-sectoral and grass-roots interests, both indicators of subsidiarity, an oft-cited goal of EU funding.

1.3 Regional Development Councils

Both the National and the Regional Development Councils make funding decisions, adjudicate over potential conflicts among the plans of lower level organizations, supervise and audit the use of grant funds by applicants and have the power to coordinate and override the goals and plans of lower level organizations at the county and micro-regional level. Both the Regional Councils and the National Council have the authority to rank counties and micro-regions in order of priority and can develop their own systems of classification, albeit in an EU-compatible fashion.

The Regional Development Councils were only formed under pressure from various EU funding sources that require plans to be made on a regional basis. Instead of creating regional governments or authorities, Hungary's seven "statistical-planning" regions form the target areas for EU funding, and legislation requires that the national budget allocate funds to each region annually. Representatives of the County Development Councils, the county assembly presidents, are the only elected officials on the Regional Development Council. The rest are delegated and subject to ministerial veto if conditions deem it necessary.

The County Development Council is the first level of organization dominated by elected officials of a self-governing body. Their role is to coordinate the various plans of municipalities and micro-regions, as well as of NGOs and private businesses. The County Development Council prepares financial plans and takes part in the allocation decisions regarding the various available national equalization funds. The Council gives grants as well as supervising the implementation and monitoring the use of funds. The Council itself may seek funds for its own operations and for the giving of additional grants. Some counties have created budgetary agencies to provide administrative support for the Councils. Others use existing administrative staff, or create non-profit foundations either alone or in cooperation with private enterprises and municipalities. Members include the county assembly president, mayors of cities with county rights within their territory and development associations created by municipalities as well as others.

Development associations established by municipalities have only one legally mandated function: approving micro-regional development plans. Given that members can only be municipalities, these development associations are governed entirely by elected officials. There are 176 such micro-regional associations and only 152 "official statistical" micro-regions, indicating that the Statistical Office's micro-regions do not necessarily reflect legitimate NUTS IV level micro-regions that are voluntarily created and organic in nature.

2. REGIONAL DIFFERENCES AND THE TRANSITION DECADE (1990–1999)

Before 1990 the socialist system made attempts to even out social and economic differences using administrative measures in line with the ideology of the day. Between 1950 and 1990 the most advanced region was characterized by heavy industry; chemical manufacturing and mining in the mountains of northwestern and central Hungary, essentially created a north-south divide where none had existed before. This industrial zone relied on coal mining and upon the import of raw materials such as iron ore from the Soviet Union, and its traditional heavy industry exported on a barter basis and ultimately for "convertible rubles" to the CMEA.

After the political changes in 1989–90 Hungary's economy rapidly reoriented itself to trade with the European Economic Community, and within that, Germany. Economic transformation, rapid privatization and quick liquidation of loss-making socialist enterprises, combined with the disappearance of both the CMEA and the Soviet Union, led to dramatic increases in unemployment and even sharper regional differences. Foreign investment poured into Budapest and western Hungary while areas formerly dominated by heavy industry received scant attention. With the collapse of both the CMEA and internal markets, the entire industrial belt faced bankruptcy and high unemployment. With essentially no labor mobility, unemployment in the 20–30% range dominated in the former industrial towns. However, formerly underdeveloped border regions with no prior industry realized that they now had major strategic advantages due to open borders. Greenfield investment moved from the Austrian border along major roads to Budapest, bypassing the former industrial zones.

The structural and transformational crisis peaked in 1993–94. Macro indicators such as unemployment, inflation, public debt and international sovereign debt began to improve significantly. Services, the financial sector and export-oriented manufacturing showed significant expansion. The structure of the economy shifted to export-oriented manufacturing and services funded by international greenfield investors in automobiles, electronics and components. The industrial crisis zones remained in place, showing little change as investment and growth took place in areas previously not afflicted by socialist heavy industry.

Several regions began sustainable development in the mid-1990s, reinforcing gaps among the successful and peripheral areas. The development gap between wealthier and less fortunate areas grew not as a consequence of any continuing structural crisis, but rather as a consequence of differential growth rates and development patterns. In other words, less fortunate areas also began to improve by the late 1990s. Greater Budapest and the northwest of Hungary, as most but not all of the indicators cited below will demonstrate, increased their advantage over the rest of the country.

2.1 Budapest's Dominant National Role

Hungary's capital plays a disproportionately dominant political and economic role, since its economic indicators in many respects are a notch above the nearest large city. The largest gaps in development and other economic indicators are not among regions or cities in rural Hungary, rather between Budapest and the rest of country. When greater Budapest, or an outer ring of villages and cities essentially a part of the metropolis are included, then this dominance is even more evident. Consequently the Central Region that includes Budapest is an anomaly. (Given that Buda and Pest were united during the golden age of the Austro-Hungarian Monarchy in 1873, the modern city was built to govern over a kingdom triple the size of contemporary Hungary.)

With 1.8 million residents within the city limits and another half a million in the surrounding areas, Budapest is Central and Eastern Europe's largest city, encompassing over one fifth of Hungary's population. Including the agglomeration areas, Budapest includes nearly a quarter of Hungary's population. Hungary's next tier of large cities barely approach 200,000 in population, resulting in a 10:1 difference in city size between the largest city and the second largest cities.[2]

When unemployment rose above 20% in the industrial belt, Budapest, always a magnet for labor resources, never suffered more than 7% unemployment. Over 65% of foreign direct investment in Hungary appeared in Budapest, where services, in particular financial services, dominate. As a result, 35% of Hungary's GDP, and more than half of its personal income tax and VAT receipts are produced there.

2.2 Regional Differences in Major Indicators

Official unemployment was first defined and measured in explicit quantities after the collapse of socialism. In the prior system, unemployment was disguised "within the gate" and restrained by administrative methods. After the collapse of the CMEA as an export market and the rapid restructuring of the domestic economy, unemployment reached a maximum national average of 12.1% in 1993. (Since then national unemployment dropped below 6% signaling that some areas in Hungary actually had labor shortages in 2000–1). That 1993 average included a low of 7% for Budapest and rates of over 25% in some blighted industrial areas. Unemployment remained below the national average in the large cities and Budapest given the social and welfare infrastructure in place that allowed low-paying jobs to persist. A special feature of Hungary's structural unemployment is that it was not confined to only the blighted zones, but since there were quite a few commuters living in distant villages, their release transmitted industrial unemployment to locations far from the original problem. These long-term, long-distance commuters who only went home on weekends were let go first. As a consequence, unemployment that emerged in northern steel mill towns was rapidly transmitted to rural agricultural areas in the plains.

Those agricultural areas were already in crisis when the newly unemployed commuters returned home. Thus pockets of industrial malaise spread unemployment nationwide. Fortunately the crisis broke in 1994, with long-term unemployment only really evident in the original crisis zones. In 2000 national unemployment had dropped to 6.4%, with the worst county rate at only 11%. By late 2001 the national rate slid below 6%, with only 4% in Budapest, essentially showing a full employment situation. By late 2002, the Central Region (including Budapest) showed an unemployment rate of 4%, with the worst region measuring 8% unemployment. The absolute and relative unemployment rates dropped by 2002, and the gap between Budapest and the poorest region also narrowed to 2:1 versus a 4:1 difference in the most difficult transition years of the early 1990s.

Differences in income and consumption correspond directly with regional differences in economic development. Accordingly, the highest indicators are produced by Budapest and northwest Hungary. A useful indicator for the consumption of durables by both the population and businesses are the number of cars per 1,000. The most rapid growth was shown in the suburbs of Budapest, as over 200,000 people left the city center in the 1990s.

2.3 Infrastructure at the Settlement Level

The gap in urban infrastructure such as water, gas, sewage treatment and telephone service has rapidly closed during the 1990s. This meant an improvement in living conditions throughout the country, even in blighted areas. Economic renewal was not hostage to the lack of water, gas or phone lines, but rather largely determined by factors such as proximity to borders and transportation access. Regarding water treatment, there is nearly universal access to piped drinking water in Hungary, while access to sewage treatment is more limited.

3. REGIONS AS UNITS OF COMPARISON

When using regions as a basis for comparison, Central Hungary with Budapest dominates all indicators of economic development and output. In addition, the two northern Transdanubian regions form the top third. South Transdanubia, however, shows a lack of development similar to areas in the plains or northeastern Hungary. Development trends show an increasing gap in terms of income, consumption and general economic development between the most developed and least developed regions. On a positive note, urban and settlement infrastructure such as water, gas and sewage service has shown significantly decreased disparity between the wealthy and less fortunate areas of the country.

Differences within each region are often larger than differences among regions. Since each region is a conglomeration of poorer and more developed counties and micro-regions, comparing regions involves creating averages that may not apply to any specific place within the region. Each region contains successful micro-regions, groupings of villages or urban areas, whose results are distorted by the effect of the rest of the arbitrary region. Development seems to follow in lines *completely unrelated* to the boundaries of the NUTS II regions or other political units, while other forms of development converge on and emerge from city-states that act as islands in otherwise failed regions. (An example would be Nyíregyháza, with only frictional unemployment, surrounded by a county with an unemployment rate ten times the rate of its county capital and a regional unemployment rate double that of Budapest).

Regional development programs intervene in market trends by attempting to pull up poorer regions, but the overall effect of such interventions pales by comparison to the volume of market-driven funds that create and reinforce these regional tendencies and differences.

4. INVENTORY AND ANALYSIS

The inventory and analysis of regional development funding in Hungary in the annex covers infrastructure that includes facilities that are either directly or indirectly indispensable for the alleviation of regional anomalies, upgrading underdeveloped areas and the provision of development opportunities for a given geographical unit, municipality, region, self-government or population.

The definition of infrastructure includes primary industry and service generation factors which are regarded by several industries, regardless of their output, as their input elements. Their presence is indispensable in regional development and the effective organization of production, consumption and services. Infrastructure could also be described simply as an economic base; nevertheless, this term is not deemed to be definitive enough.

The inventory in the annex details the funds that contribute to regional development projects and the relevant financial volumes are also indicated. Here, only such funds will be discussed that have or ought to have some regional aspects. However, the legislative stipulation of the many municipal responsibilities was not followed up by the allocation of adequate central funding; consequently the limited financial possibilities of the self-governments and municipalities proved to be a barrier to kick-starting the necessary infrastructure development projects. The insufficiency of funds contributed by the self-governments and municipalities themselves caused the environment protection projects to become far too dependent on central budget allocation, and the volume of renovation projects falls short of covering the annual depreciation rate of assets.

As EU accession approaches, there is an increasing need for local public capital investment infrastructure projects. However, given the high number of austerity measures, the level of government support provided for self-governments and municipalities is constantly decreasing in real-terms. Therefore, in view of the decreasing real-term revenues of self-governments and municipalities, a shortage of funding for capital investment projects can be expected in forthcoming years.

The annex also analyzes the volume of regional development expenditure in the individual sectors, i.e., the role the government plays in the sectors of water management, sewerage, waste management, provision of gas, industrial parks and tourism. Primary data are available on the magnitude of funds flowing into the individual sectors, but it is difficult to identify the distribution of funding sources per individual project or project type. The available data clearly reflect the magnitude of certain centralized funds, e.g., the absolute and relative volume of targeted and addressed support grants allocated to capital investment projects, but the distribution of the funds used and their absolute volume by segment cannot be identified. In other words, there is no national or regional breakdown to indicate the volume of grants by individual completed infrastructure project.

5. EVALUATION AND CONCLUSIONS

For the purpose of this paper, the Hungarian research team proposed a scaling system to evaluate domestic and EU regional development funds aimed at improving infrastructure in the transitional countries. That grading system and general results are reproduced below. Comments on each EU criteria such as concentration, programming, etc., are given at the end of this executive summary. The tabulated evaluation along five predefined criteria uses a scale of five grades where grade one indicates that a given criterion is hardly met whereas grade five indicates that a given criterion is fully met.

5.1 Concentration

Under the criterion of concentration the analysis asks whether the given funds are provided in a coordinated way and focused sufficiently on the tasks to be implemented, or scattered across various sectors.

- Programs scored the highest grade where the equalization of regional anomalies is a fundamental goal.
- Programs where apart from the equalization of regional anomalies other aspects (sectoral ones) are also significant scored four points.
- Programs where regional equalization and sectoral aspects carry approximately the same weight scored three points.
- Programs where regional equalization is only a subordinated aspect have scored two points.
- Programs where the equalization of regional anomalies plays no part at all scored one point.

5.2 Programming

- Programs that are fully in line with a development strategy that encompasses several sectors or are part of such a strategy have scored five points.
- Programs that are to a high extent in line with a development strategy encompassing several sectors have scored four points.
- Programs where the development strategy encompassing several sectors carries approximately the same weight as the given development projects have scored three points.
- Programs where compatibility with the development strategy encompassing several sectors is only traceable have scored two points.
- Programs that are incompatible with a strategy encompassing several sectors have scored only one point.

5.3 Partnership

Under the criterion of partnership we analyzed the scope of government coordination, whether all the stakeholders have been sufficiently involved in the decision-making process and whether there is central dominance or the decisions are based on consensus.

- Programs and funds where the stakeholders are fully involved and the decisions on the allocation of funds are not automatic score five points.
- Funds where partnership is mostly visible but is not always perceivable in the decision-making processes score four points.
- Funds where partnership in support issues is only formal, and one of the parties outweighs the others score three points.
- Funds where there is only some semblance of cooperation score two points.
- Programs where decisions are quite openly made without any cooperation score one point.

5.4 Additionality

- Programs that may usually be implemented with 50% or more matching funds scored five points.
- Programs scored four points where substantial matching funds are required.
- Programs scored three points where more than nominal matching funds are contributed.
- Programs scored two points where there is only a nominal matching fund requirement.
- Programs scored one point where no matching funds are required.

5.5 Transparency

- Five points were scored by programs where the terms and conditions as well as the procedure preceding the award of the grant are absolutely transparent, and information—(a) on the size of the program, (b) the amounts of committed vs. uncommitted funds at any point of time during the program and (c) the list of grant recipients—is clear and available to all interested parties.
- Programs that have less transparent or fairly complicated and intricate components in their terms, conditions and proposal evaluation and monitoring processes scored four points.
- Three points are scored by programs which are fairly transparent and can be kept track of, but contain elements in the terms and conditions, the awarding procedures or in the use of funds that are uncertain and resist the scrutiny of the public.
- Two points are scored when the terms and conditions are somewhat transparent when the program is launched, but as the program progresses they become increasingly nebulous, ending up completely opaque at the end of the day.

- One point is scored when it is only the outline of the program that is perceivable, but the terms and conditions for the submission of proposals and the proposal evaluation procedures are only known by the initiated.

Table 3.1
Assessment of Major Regional Development Programs in Hungary

Regional Infrastructure Support Type	Concentration	Programming	Partnership	Additionality	Transparency
PHARE program	5	5	1	4	3
SAPARD program	2	5	4	5	3
ISPA program	2	5	2	5	3
Targeted and addressed grants	4	2	3	3	4
Rural development targeted appropriation	5	4	4	5	3
Economic development targeted appropriation	3	4	2	5	2
Regional economic development targeted appropriation	3	4	2	5	2
Targeted appropriation for small and medium businesses	3	4	2	5	2
Targeted appropriation for tourism	3	3	2	5	2
Environment Fund targeted components	3	2	3	5	2
Water management targeted appropriation	3	3	3	5	3
Targeted appropriation for road maintenance and development	2	2	3	5	4
Tax relief	4	4	2	1	5
PHARE programs for human resource development	5	5	1	4	3
Labor Market Fund	4	4	4	3	4
Labor force development under the Ministry of Social and Family Affairs—PHARE	4	5	3	5	2
Labor force development under the Ministry of Social and Family Affairs—community works program	4	4	2	1	4
Student loans	1	1	1	1	2

6. ANALYSIS OF IMPLICATIONS

6.1 Concentration

- Disparities in the levels of unemployment have moderated in the 1990s as a consequence of economic growth, with foreign investment perhaps levelling out inequalities in physical infrastructure.
- Income disparities between Budapest and the rest of the country, the central region and northern Transdanubia versus the rest of the five regions have widened as a consequence of high income jobs being created by foreign investment.
- The apparent income gap between city and rural areas has widened.
- Unemployment dropped to 6% on average in 2002, with 4% in Budapest and only 8% in the worst-off region. This indicator shows relative and absolute improvement for all regions.
- Regional policy reinforces successful and otherwise attractive regions. With the exception of physical infrastructure such as roads, water and waste water facilities, regional policy does not overcome regional disadvantages.
- Telephone (fixed and mobile) service is universal with over 50% penetration of both throughout the country. There are few disadvantaged areas regarding access to the most advanced telecom services.
- Instruments to attract investment to less advantaged areas such as local tax exemptions, corporate tax breaks and relief from some payroll taxes in distressed areas have been deemed as incompatible with EU membership. Individual exceptions are being negotiated for the largest investors. Local tax policy will be handicapped by EU requirements for equal treatment regardless of the underlying economic condition of the community giving tax exemptions to encourage private investment.
- Development funds are scattered across sectoral ministries and national agencies.
- Poorer areas do not have the capacity to plan, prepare or execute projects that require a contribution from their own funds.
- Investment follows existing (Győr–Székesfehérvár–Budapest) communications links and anticipates improvements to physical infrastructure when seeking new sites (Nyíregyháza).
- Foreign investors attracted by tax benefits and cheap labor have begun to select sites and to shift production from Hungary to Romania and Ukraine where labor remains relatively inexpensive.
- Public investment in communications and environmental infrastructure seems to facilitate greater regional equalization than industrial development subsidies and tax schemes.

6.2 Programming

- Cross-sectoral strategies do not seem to guide the distribution of ministerial and national agency funds
- There are dozens of funding channels for similar projects with no apparent coordination.
- Regional and national plans seem to be written for providing the prerequisites of EU funding under Interreg, PHARE and other programs, rather than being truly comprehensive, bottom-up documents.
- The NUTS II regions face the constitutional and administrative challenge of developing executive bodies and public oversight so that they may receive and guide the use of EU funds up to and after accession.

6.3 Partnership/Subsidiarity

- Regional institutions, local governments and "socio-economic partners" associated by and with national governments are not effectively involved in the selection, design and execution of public investments in:
  1) local infrastructure;
  2) income/employment promotion;
  3) human resource development.

6.4 Additionality

- Co-financing is interpreted as the host country's contribution to a project funded in part by the EU.
- Beneficiaries such as municipalities, counties, micro-regions and regions do not have the financial capacity nor authority to provide proper co-financing, co-payments or "self-contributions."
- National ministries and agencies require co-financing in domestic projects by beneficiaries such as municipalities. These are seldom in cash and in reality do not exceed 5–10% of the total project cost. (Often this is in the form of in-kind contributions or the designation of other donor funds as "self-contributed.")
- There are proposals being formed by the new Socialist government to design a special equalization fund to give poorer communities grants that they can use in co-financing. The lack of own source capital funds, and the inability to generate operational surpluses and local taxes are the major obstacles and dividing lines that

define whether a community is able to take part as a "partner" using the principle of "additionality."
- Future EU co-financing requirements seem to be met by national-level co-payments that appear as a specific line-item in the state budget.

6.5 Transparency

- While the evidence is anecdotal and sparse, it seems that formal regional development grants and programs, both domestic and those donated by the EU and others, are run on a transparent basis.
- Public procurement laws, appeals processes, the State Audit Office and other investigative offices are available to address the complaints of bidders.
- In an informal sense, selection criteria are not clear, and the on-going and *ex post* external review of public funds does not seem to be adequate.
- The complaint of many bidders seeking public funds is that their bids are collected by an agency, the bid is cancelled for technical reasons, then re-announced with the ultimate winner (who may have not even been a part of the original call for bids) having being given access to the rejected bidders' materials. Using this method, unstoppable bids can be assembled.

ENDNOTES

1 The Central Region municipalities seek to remove Budapest from the region in order to stay below the 75% of the average EU GDP threshold farther into the future.

2 Budapest's traditional "twin city" was Vienna, while most of the next tier cities of historical Hungary are now in countries surrounding Hungary, such as Bratislava, Timisoara, Kosice and Uzsgorod. Budapest simply has no competition for resources within Hungary and is thus forced to compete with Vienna and other large cities in Central Europe. Hungary's road and rail network is entirely Budapest-oriented since other regional hubs now lie in surrounding countries and the transportation system has not recovered from the shock of two world wars and several changes in borders in the 20th century.

Capital Investment Funding in Latvia

Mudite Priede
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Capital Investment Funding in Latvia

Executive Summary

Mudite Priede, Agita Strazda

1. CONCENTRATION

1.1 National Policies and Activities Addressing Regional Disparities

In the mid-1990s, the government of Latvia, and in particular the Ministry of Economy and the Ministry of Environment and Regional Development, acknowledged the need to identify problem regions within the country and started to plan national level programs to address the development issues of these regions. As a result, there is no shortage of statistics available at the *pagast* level (the lowest local government level in Latvia), and the Annual Statistical Yearbook offers a mass of data covering a wide range of indicators. Using this data and other sources, the Ministry of Environmental Protection and Regional Development has published a booklet of over thirty maps that show the variation at *pagast* level of a selection of socio-economic and other indicators.

In this context, work initiated by the Ministry of Economy some years ago sought to identify the major types of problems that regions in Latvia face. These were grouped as follows:[1]

- Regions that feature poor socio-economic development;
- Regions with poor agricultural development;
- Regions experiencing economic decline;
- Regions along Latvia's borders, especially those territories in the east;
- Coastal regions;
- The Riga metropolis;
- Regions with transportation corridors such as Via Baltica and the West–East transport corridor;
- The region containing the radar station at Skrunda;
- The Liv Shore.

Given such a comprehensive list, it is not immediately apparent just what parts of Latvia, if any, are considered problem free. Furthermore, the means by which such regions might be defined were not specified, nor in some cases was the nature of the problems.

The rationale for identifying problem regions must be that, once identified, these regions can benefit from policies directed at solving the specific problems that each region faces.

The following initiatives are those that demonstrate the significant attempts that have already been made to address the question of regional development:

- Latvian Regional Development Policy;
- The identification of problem areas and the establishment of the Regional Development Fund;
- Latgale Development Project;
- Urban and rural pilot projects under the SPP;
- The Coastal Investment Strategy;
- Support for preparation of municipal and regional development plans;
- Rural Development Program;
- SME Development Program.

Each of these has been described in some detail in the report on the CD attached to this volume, but it is useful at this stage to note the objectives of the Latvian Regional Development Policy, which offers a comprehensive and wide-ranging approach to the subject. These are elaborated as:

- Creating the preconditions for ensuring a favorable and equal living environment, living and working conditions in all regions of Latvia;
- Decreasing and averting unfavorable regional differences and supporting preservation of positive differences;
- Ensuring sustainable development in Latvia and its regions, bringing the economic activity in line with preservation and enhancement of cultural and natural heritage;
- Creating preconditions for the integration of Latvia into the EU and the processes of its regional development.

Unfortunately, the development of regional policy in Latvia suggests that, despite the existence of the Latvian Regional Development Policy, there is considerable uncertainty about the nature and scale of the regional disparities, even though much work has been undertaken by the statistical office and the ministries in identifying problem regions. There is a lack of clear objectives associated with the actions currently underway, although this is understandable given the lack of quantified information. The concept has not been followed by regional development policy or activity programs to address disparities through coordinated regional investment programs. The programs mentioned above chiefly exist on paper; nonetheless, they can hopefully be used for developing specific programs for particular regions in the future.

There is also little evidence of any monitoring and evaluation processes to determine the effectiveness of the strategies and little coordination among the policies and strategies that exist within the various ministries, despite the existence of numerous inter-ministerial working groups.

Thus, in reality the only policy and financial instruments addressing regional disparities are the Program for Assisted Regions and the Regional Development Fund.

With the limited resources available to address all the problem regions, the decision was taken to identify those deserving of special assistance by reason of suffering long-term negative economic and/or social development trends. The Law on Assisted Regions is the enabling legislation that determines the general procedure for granting the status of assisted region and for promoting its economic development.

The power for granting and withdrawing the status of assisted region rests with the Cabinet of Ministers. The decisions are to be based upon statistical data, experts' estimate of the regions' development prospects and other indices but the Law is not specific about how these data, estimates and other indices are to be determined. Collectively, the assisted regions should not constitute more than 15% of the national population.

The problem regions were identified on the basis of ranked statistical indicators agreed to by the Cabinet of Ministers. One of the consequences of ranking of regions using a mix of indicators is that it is not then possible to determine what specific problems face the selected regions. It is therefore not possible to use the identification of troubled regions to help shape national sectoral policies to address specific regional problems. It is not surprising that other than the establishment of the Regional Development Fund, no national sectoral policies directed at these assisted regions materialized. In support of the Regional Development Fund it should be said that the fund still managed to create a significant number of jobs and support entrepreneurship activities in the most deprived regions of Latvia.

Other sectoral programs addressed the regional disparities in a fragmented or *ad hoc* way, typically with little coordination between sectoral policies.

1.2 Activities of Local and Regional Governments in Addressing Regional Disparities

According to several legal acts, the Local Government Law, the Spatial Planning Law and the Regional Development Law, local and regional governments are responsible for preparing and managing socio-economic, territorial and spatial plans for their areas. The majority of local and regional governments have developed such plans and, in tandem with their budgets, have attracted other investments to assist their implementation. Several years ago bigger cities and districts took the lead in initiating development policies for territories larger than one rural municipality or district and the Ministry of

Environment and Regional Development supported this process. Thus the first regional macro-level development program was created—the Latgale Development Program (the most deprived macro-region in Latvia on NUTS III level) in cooperation with the newly established Latgale Development Council. This was followed by the establishment of the Latgale Development Agency, which is responsible for the actual implementation of the program and attracting inward investment.

Other local and regional governments followed this example and a total of five planning regions have now been established in Latvia, the territories of which correspond to NUTS III level. The process of the development of planning regions was held up by slow government decision-making regarding local government and regional reform. Local and regional governments acknowledged the need for bigger regions for economic development purposes whilst the government debated whether to classify three, five or nine regions. Naturally, EU Regional Policy requirements regarding the programming and management of regional programs also influenced the process.

All planning regions have been voluntarily set up on the base of agreements between all levels of local and regional governments within the particular regions. All planning regions have councils as decision-making bodies, which are chaired according to a rotation principle. All municipalities that signed the agreement on the establishment of planning regions have assigned certain financial resources to run the development agency. The government has recently assigned resources from the state budget to aid the building of the Regional Development Agencies in the five planning regions.

Each of the planning regions has undertaken SWOT analyses of the regions and begun preparation of regional development strategies.

There is an ongoing debate concerning possible regionalization in Latvia. This debate was very topical more than a year ago, when Latvia had to make the decision on how the PHARE Social and Economic cohesion will be managed in the country. Since there were no administrative regions of NUTS III level, planning regions were involved in preparation of PHARE social and economic cohesion projects. This raised even more questions concerning the pros and cons of bigger administrative regions. Another problem related to regionalization was the redistribution of functions from central to regional level—something that the ministries were not capable of carrying out at that point in time.

After the EU expressed the strong view that Latvia will be treated as one NUTS II level and money will be assigned on the base of one single programming document (National Development Plan), it created embarrassment regarding the further development of regions (planning or administrative). At present there is a noticeable slowdown in the further development of regional reform, especially as parliamentary elections are looming. Nevertheless, planning regions still actively deal with planning issues and attraction of investments.

1.3 EU PHARE Social and Economic Cohesion Funding

The rationale for adopting a regional development approach is that it promotes economic and social cohesion by providing a mechanism by which resources (whether local, regional, national or international) can be allocated on the basis of identified and agreed priorities. Whether those priorities are about reducing regional disparities (the equity approach) or about the best allocation of limited resources on a straightforward cost-benefit approach at the national level (the efficiency approach) is a question to be answered.

With the introduction of the first year of EU PHARE Social and Economic Cohesion (EU SEC) funding, the government agreed with the EU that 10 million EUR of EU SEC money will go to the regions on the basis of regional development programs. Since there was no coherent national level regional policy addressing regional issues (the National Development Plan was still in the development stage) the solution was to assign money for the regions (planning regions) that were most able to manage EU SEC funds. The planning regions were required to submit expressions of interests certifying that they have political and administrative management of planning regions (Development Council and Development Agency), that they have a regional development plan and investment project proposals in line with this development plan. All five planning regions submitted the expressions of interests and the decision was made by the Cabinet of Ministers that the first year assistance would go to the Latgale and Zemgale regions. The resources were planned to target capacity-building of the Regional Development Agencies to prepare and manage grant programs and to pilot projects in the sphere of productive investments and the support of entrepreneurship.

However, the following year the decision was reversed, i.e., there was no longer to be a regional approach. This was brought about by the following statement in the EU document, *PHARE 2000 Review:*

> "… smaller countries such as the Baltic States and Slovenia whose national territories equate to a NUTS II like region may opt only for sectoral schemes at the national level, generally including some form of regional concentration. … A country's choice of implementation structure is also flexible. Regional programs need not be implemented by regional structures. They can be implemented by national ministries/agencies, if more appropriate."

Thus PHARE Social and Economic Cohesion money in 2001 was available nationwide, which resulted in better prepared investment projects in the bigger Latvian cities. The selection of the projects was made mainly on the basis of the quality of the projects, but did not take in account any national or regional programming documentation.

This decision led to the creation of a lack of motivation among the planning regions to continue the development of arrangements necessary for preparation and management of regional programs.

2. PROGRAMMING

2.1 National Planning Framework

National programs are medium- and long-term target programs focused on priorities of the state. National programs cover the aggregate of activities to be implemented by the government in a certain area or a sector where such implementation is important for the development of society and the Latvian economy. Regulation No. 129 of the Cabinet of Ministers of May 9, 1995 on the Procedure of Development and Implementation of National Programs currently guides issues linked with the development of national programs. Out of fifteen programs included in the list of national programs approved by the Cabinet of Ministers, eleven programs are already developed and approved by the government.[2]

Table 4.1
List of National Programs

Drafted/implemented national programs:
1. National Program of Quality Assurance (responsible institution—Ministry of Economy);
2. National Program of the Development of Energy Sector (Ministry of Economy);
3. National Program for the Development of Small and Medium Sized Enterprises (Ministry of Economy);
4. National Program on Foreign Trade (Ministry of Economy);
5. National Program on Biological Diversity (Ministry of Environment Protection and Regional Development);
6. National Program on Development of Tourism (Ministry of Environment Protection and Regional Development);
7. National Program of Transport Development (Ministry of Transport);
8. National Program on Information (Ministry of Transport);
9. National Program on Road Traffic Safety (Ministry of Transport).
10. National Program on Culture (Ministry of Culture);
11. National Program: Population of Latvia (National Health and Social Security) (Ministry of Welfare);

Table 4.1 (continued)
List of National Programs

Programs in the process of drafting:
1. National Program for Protection of the Environment of the Baltic Sea (Ministry of Environment Protection and Regional Development);
2. National Program on the Regional Development of Latvia (Ministry of Environment Protection and Regional Development);
3. National Program on Construction (Ministry of Environment Protection and Regional Development);
4. National Program: Production and Utilization of Biological Fuel in Latvia (Ministry of Agriculture).

The programs listed above are sector policies and programs that have no funds assigned to them, but which serve as a base for ministries' bidding applications to the annual budget. In short, this means that some of the activities or projects within each sector program are implemented depending on the decision of the Cabinet concerning specific ministry allocations.

At one stage the Regional Development Council initiated the debate on the need to evaluate sectoral programs in light of the regional dimension taken into account in preparing these programs. The problems with the various regional initiatives undertaken by ministries are the lack of clarity of purpose and the consequent uncertainty of the strategies employed together with the difficulty in assessing the effectiveness of their contribution to the regional development objectives as set out in the Regional Development Plan. The preparation of the National Development Plan is seen as a way to establish a coherent approach in dealing with regional development issues, but this is still some way off.

2.2 EU Structural Funds

National Development Plan

The EU has emphasized that it is particularly important for applicant countries to ensure that the plans do not focus exclusively on regional or sectoral issues but take full account of the national and international context. The various national plans will therefore need to start from an understanding of the ability of the applicant country concerned to meet the three types of condition for accession to the EU.[3] This means that attention will need to be paid to the National Program for European Integration and the National Budget and sectoral program (including the Public Investment Program). Regional development strategies can only be fully effective when they are developed with an appreciation of their wider context.

Nonetheless, while activity across all of the national territory of applicant countries will be eligible for assistance, the National Plans will be expected to include a description of regional disparities and development gaps and, where appropriate, proposals to respond to these. Such proposals may either be treated by a specific measure(s) or horizontally (that is to say across a number of sectoral measures). This raises a number of questions such as whether different regions should be eligible for different types or simply different levels of assistance or whether all disadvantaged regions need to receive assistance during the same programming period. However, perhaps the most fundamental questions to be resolved relate to the definition and delineation of regions.

If we were to follow the current practices within the EU in relation to Objective 1 regions the national development plan would include (among other things):

- A description of the current situation with regard to regional disparities and development gaps;
- A description of the appropriate strategy to achieve the regional development priorities selected, quantified where they lend themselves to quantification;
- A prior appraisal of the expected impact, including that on jobs, of corresponding operations with a view to ensuring that they yield medium-term economic and social benefits in keeping with the resources deployed.

However, the plan does not state how this vision will be implemented.

The NDP sets three priority areas:

1) Promotion of employment and competitiveness,
2) Development of human resources,
3) Development of infrastructure.

Yet, the identification/selection of development objectives/targets to be followed by action plans (and later by concrete projects) is missing. Nor is there an identification of the ways to achieve the objectives (e.g., financial planning, coordination between various sectors, type of activity or action plan, etc.).

The definitions of strategic objectives and development trends for each of the regions is presented in the plan, but no measures are suggested to address the regional disparities.

3. PARTNERSHIP/SUBSIDIARITY

3.1 National Funding Mechanisms

To date, there has been no common partnership system in place with respect to the planning, managing and monitoring of national programs and funding mechanisms; in the main the programs have been administered by ministries or state agencies. Management and monitoring have been performed through councils, boards, coordination committees and commissions consisting of representatives of various ministries and state institutions linked to a particular program or fund. In some cases social partners have been involved at the consultation stage, but the only social partner continually involved in managing and monitoring of state assistance programs was the Union of Local and Regional Governments of Latvia. Even in the case of the Assisted Regions Program and the management of the Regional Development Fund the only social partner was the Union of Local and Regional Governments, whereas the other members of the Regional Development Council were representatives of the ministries and even MPs. With the introduction of EU Structural Funds (involving preparation of National Development Plan, SAPARD, EU Social and Economic Cohesion, Special Preparatory Program for introduction of EU Structural funds in Latvia) the role and composition of the Regional Development Council will be changed.

3.2 EU Structural Funds

Starting in 2000, one of the responsibilities of the Latvian administration was to monitor EU pre-accession financial instruments. Therefore procedures to ensure effective monitoring of PHARE, ISPA and SAPARD activities were set in place and monitoring committees were established.

During the organization process of the SAPARD and ISPA Monitoring Committees (MC) experience already has been gained on the involvement of social and economic partners in discussions to ensure effective and qualitative implementation of the programs.

The composition of the SAPARD and ISPA Monitoring Committees is stipulated in the national legal acts. It ensures that the SAPARD MC consists of representatives from line-ministries, local municipalities, different non-governmental and socio-economic institutions and representatives from the EU.

Membership of the ISPA MC is already stated in national legal acts as well as in the Rules of Procedure for the ISPA MC. It consists of representatives from line-ministries, the EU and local municipalities as well as contractors. After discussions held with environmental NGOs it has been agreed to ensure the possibility for them to participate in the ISPA MC as observers.

It is envisaged that the Structural Funds MC will consist also of the representatives of social partners and statutory bodies representing equal opportunities, environment, poverty and rural development dimensions. The organizations to participate in the process will be identified at a later stage during a consultation process based on the partnerships established during the preparation of the Development Plan.

Taking into account the experience gained during the development of the monitoring system for the EU pre-accession financial instruments, first steps have been taken for establishment of the Structural Funds MC. In the guidelines adopted by the Cabinet of Ministers on March 19, 2002 it is proposed that representatives of public authorities, social and economic partners and others will form the committee. The following membership structure is expected:

- Ministry of Finance—Chairperson (representative of Managing Authority);
- State Treasury (representative of Paying Authority);
- Partner Institutions (Ministry of Welfare, Ministry of Agriculture, Regional Policy and Planning Directorate);
- Intermediate bodies;
- Line-ministries (Ministry of Economy, Ministry of Education and Science, Ministry of Transport, Ministry of Environmental Protection and Regional Development);
- Five planning regions and Union of Local Governments;
- Social partners;
- Statutory bodies representing equal opportunities, environment, poverty and rural development dimensions;
- European Commission (Observer);
- International Financial Institution—European Investment Bank (Observer).

The Cabinet of Ministers will clearly define responsibility of each body involved in the management of Structural Funds. The Monitoring Committee will be the only decision-making body led by the Managing Authority. The Monitoring Committee has the right to establish specific task-oriented working groups if necessary (the text of the guidelines adopted on March 19, 2002 states that the Monitoring Sub-Committees could be established; however, now it has been agreed that this approach will not be followed and only one Monitoring Committee will function for monitoring of the Structural Funds).

3.3 National–Regional–Local Partnership

The new Regional Development Law provides for the establishment of a National Regional Development Council (NRDC) that will perform the functions of the coordinating institution in the area of regional development at the political level. The NRDC will include representatives from the Cabinet of Ministers and appointed representatives from five planning regions. It is planned that upon its creation the NRDC will take over the functions that the management group is currently performing. However, the most probable outlook is that this will happen no earlier than January of 2003, which clearly indicates that the current state of play will remain at least until the finalization of the Development Plan.

The status of planning regions is also legitimized with the adoption of the Regional Development Law, while the representatives of all five planning regions have been actively participating in the preparation of the National Development Plan, and according to the new amendments to the decision on the Management Group of the National Development Plan, they are involved in the process at operational and decision-making level.

Coordination of each planning region will be carried out by the Planning Region Development Council (PRDC). The council will provide coordination of the development of the planning regions in line with the priorities identified in strategic development planning documents. In each planning region a joint agency of local governments—the Planning Region Development Agency (PRDA)—will be established to ensure coordination between municipalities, and to assist municipalities in planning and promoting projects of a regional scale.[4]

4. ADDITIONALITY

4.1 National Funding Mechanisms

The requirements, procedures and system of co-financing investment projects from national funding mechanisms were determined by sources of funding and differed from case to case. Co-financing for investment projects in the 800+ program constituted funding from the state budget, PHARE program, DEFCO (or other foreign donor) bank loan and local or regional government own resources.

4.2 EU Structural Funds

The process of budget planning, approval and implementation in the Republic of Latvia is regulated by:

- The Law on Budget and Financial Management (adopted by Saeima on March 24, 1994);
- The Law on Local Governments Budgets (adopted by Saeima on March 24, 1994).

The existing legislation in the field of the state budget and financial management—the budget development and performance, including activities of control and responsibility, as well as the existing methodological documents (procedures)—provide the framework for the management of the EU pre-accession financial instruments and Structural Funds. As a consequence, there is no need to elaborate new legislation or make amendments to existing legislation of the Republic of Latvia.

Since 1997, the annual state budget law has been developed according to the program principle. The Law on Budget and Financial Management states that the budget program is an interrelated totality of measures and services that are oriented towards a common objective or a set of closely related objectives.

EU financial support—pre-accession financial instruments ISPA and SAPARD—are planned within the state budget program of the relevant line-ministry: e.g., the Ministry of Environmental Protection and Regional Development is responsible for implementation of projects in the field of environment protection financed by ISPA and the Ministry of Agriculture is responsible for implementation of projects financed by SAPARD.

Strict planning and accounting is assured through single economic classification codes of budget expenses on foreign financial support and state budget co-financing.

The Law on Budget and Financial Management foresees the mid-term planning of the state budget. Mid-term planning of the state budget is the process where available resources are identified for a period of five years and the use of the resources is assured according to government defined priorities. At the same time the resources of the EU funds and state budget co-financing are planned for the complete implementation of the program (project) including the total required financial input. The implementation follows this procedure: where planned projects for the state budget program are implemented for a period longer than the current budget year, the required resources from the EU funds and state budget co-financing are stated as long-term public commitments (in an annex to the annual state budget law). The long-term public commitments include public investment projects, payments for loans and credits, payments within international programs, projects and leasing.

The state budget law contains long-term public commitments showing all the necessary financial resources required for the next year, the year after that and the total amount for the completion of a project. Thus parliament approves the commitments of a program for the total period of its implementation. Long-term programs (projects) approved by the government are included as long-term state commitments, and the respective financial resources are planned according to the stated time of program (project) implementation, e.g., if the program (project) implementation period is stated for 6 years the financing of the program (project) is included as a long-term commitment for the total implementation period. The financial aspects of a program (project), split up into several years, can be updated taking into account the rate of progress of the program (project) implementation. The same is applicable to programs (projects) under the EU pre-accession financial instruments—ISPA and SAPARD.

Public investment projects are included in the Public Investment Program (PIP). The government approves PIP every year for the next three years, where the following information is specified: PIP projects grouped by ministries, the total costs of projects financed from ISPA pre-accession financial instrument and grouped by years—up to complete project implementation, as well as all financial sources—financing from EU financial support funds and proper national co-financing (state budget, local governments' budgets and co-financing from the private sector).

Latvia proposes to use the same approach for the implementation of programs financed by the EU Structural Funds. The resources of the EU Structural Funds and related state budget co-financing will be planned as long-term public commitments (included as an annex to the annual state budget law), specifying the total required financial resources for the next year, the year after that and the final amount up to the end of the project implementation. The commitment will be made to cover the total program period of the SPD.

Appropriate funding of the EU Structural Funds will also be planned within the state budget program of each related ministry (partner institution). Both groups of financial resources—financing from the EU Structural Funds and state budget co-financing will have their own economic code of budget expense. The information will be provided on planned EU Structural Funds resources as well as on related national co-financing (contribution) for all levels of SPD—from the projects up to the priorities of the SPD. There will be a planned state budget program for each priority in the SPD.

The budget and financial management law and the annual state budget law allow transfers of financial resources between priorities that are included in the state budget programs. On the basis of proposals by the Managing Authority, the Monitoring Committee will take decisions on transfers of funds between priorities regarding structural instruments. In case of transferring funds within the framework of one budget program there is no need to amend the state budget law—transfers can be made at the management level (related ministry level). Depending on the final beneficiary for implementation of a project, projects can be co-financed solely by the state budget as well as co-financed by local authorities, the private sector and other institutions. Sources of national co-financing will be determined at the stage of project preparation. The co-financing from local authorities can be set as a compulsory precondition for implementation of projects by local authorities.

Taking into account the current system of management of the EU pre-accession financial instruments during the approval process of projects, the total financial flows and sources are reviewed and accepted. The co-financing of the state budget is approved in the annual state budget law.

In order to ensure availability of the co-financing that is not approved in the annual state budget law co-financing agreements are concluded where the amount of co-financing is stated.[5]

5. TRANSPARENCY

5.1 National Funding Mechanisms

The clarity and transparency of information relating to the availability, allocation and utilization of national funding programs has been poor to date. Even with funds that have existed for several years potential beneficiaries did not have sufficient information about the selection criteria or even about the availability of the particular funding.

Only in rare cases was the distribution of funds clearly defined and adequately publicized. Moreover, the project selection procedure in the majority of cases has been unclear. The latter situation has been better only in the cases when co-financing existed from foreign donors (e.g., World Bank–Municipal development fund, Program 800 + —PHARE). Worse still, there has been no *ex post* monitoring or evaluation of projects.

5.2 EU Structural Funds

The guidelines on management, monitoring, evaluation and control system of the EU structural instruments passed by the Cabinet of Ministers of the Republic of Latvia state:

> According to the Regulation 1260/1999, as well as the EC Decision 94/342 on information and publicity for the activities related to the assistance provided within the framework of the Structural Funds and other financial instruments in the EU Member States, as well as in accordance with the Latvian legislative acts it is being established that:
>
> The Managing Authority ensures the realization of the proper information and publicity measures in relation to the Development Plan.
>
> The Managing Authority is responsible for the implementation of the information and publicity measures in relation to the Structural Funds. The Managing Authority may delegate certain publicity functions to the partner institutions as well as to the intermediate bodies.

The objective of the information and publicity measures is to inform the Final Beneficiaries as well as the social and economic partners, non-government institutions and other parties interested in the possibilities provided by the Structural Funds, the role of the EC and other institutions involved and the results achieved, thus ensuring the transparency of the assistance provided.

The Managing Authority ensures the preparation of the unified information strategy and the necessary complementary documents in the following fields:

- availability of the information;
- publicity provisions for the stakeholders involved in the implementation; compliance verification.

The Managing Authority ensures that the information useful for the final beneficiaries, social and economic partners, non-governmental organizations and other parties interested will be supplied in the most appropriate format and via the most suitable channels for the recipients. For the purposes of provision of information on the requirements and the procedures for the final beneficiaries the information guidelines and other explanatory documents will be prepared. Society at large will be informed on the progress of the measures undertaken within the Structural Funds intervention using the traditional media relation methods, such as press releases, publications in the local and national press and conferences. The Managing Authority may delegate certain information and publicity functions to the partner institution or intermediate body.

Internet has an important role to play in the information dissemination. Other high technology possibilities, such as web-conferences and others, may be employed as well.

The possibility to initiate regular news bulletin will be considered with the intention to raise the awareness of the social partners and the public at large.

In order to increase the understanding of the assistance provided by the European Community, the Managing Authority will ensure the introduction of the requirements related to information provision including the visual guidelines for the final beneficiaries to be the integral part of the project documentation set. Some other requirements to the final beneficiaries concerning the information strategy will be defined at the later stages of the preparation of the plan and its program complement.

In order to identify other information needs of the final beneficiaries sociological surveys and other types of minor scale research initiatives will be introduced.

Table 4.2
Evaluation of Regional Development in Latvia

Support	Concentration	Programming	Partnership	Additionality	Transparency
PHARE program	4	3	4	3	3
SAPARD program	5	4	4	4	4
ISPA program	5	4	4	5	3
European Union Cross-Border Cooperation programs (CBC, Baltic Project Facility, and CREDO)	4	4	4	3	5
Earmarked subsidies for territorial planning	4	4	4	4	4
Regional development fund	4	3	4	3	3
Public Investment program	1	3	2	3	2
The Municipal Development Fund	3	3	4	5	4
The Rural Development Program	3	3	4	4	3
The SPP Urban Pilot Project	5	4	5	5	4
The SPP Rural Pilot Project —Ministry of Agriculture	5	4	5	5	4
The 800+ Program—(water management)	5	4	3	5	3
Program 500—(waste management)	5	4	3	5	3
State Road Fund	4	3	4	4	3
The Port Development Fund	1	2	4	3	3

ENDNOTES

1 *Regional Economic Development in Latvia, The goals of regional economic policy,* Dr. Edvins Vanags.

2 Report of the Ministry of Economy on National Economic Development.

3 These are the Copenhagen conditions:
- Guarantees for democracy and respect for human rights and good-neighborly relations;
- Developing a viable market economy able to withstand competition in the Union's internal market;
- Ability to meet obligations related to Community Acquis (EMU, standards, etc.).

4 The Position Paper of the Republic of Latvia on Chapter 21: Regional Policy and Coordination of Structural Instruments.

5 The Position Paper of the Republic of Latvia on Chapter 21: Regional Policy and Coordination of Structural Instruments.

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1) Report on National economic Development, Ministry of Economy, Republic of Latvia.
2) Regional Development Law.
3) Accession partnership document.
4) National Development Plan of Latvia.
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6) Guidelines on management, monitoring, evaluation and control system of the EU structural instruments passed by the Cabinet of Ministers of Latvia.
7) The position paper of the Republic of Latvia on Chapter 21: Regional Policy and Coordination of Structural Instruments.
8) Materials and reports from Special Preparatory Program for Introduction of EU Structural Funds in Latvia.
9) Final reports from the PHARE project Latvian Regional Development Strategy by Simon Johnson, Conor Kearney, Ieva Kalnina, Agita Strazda.

Capital Investment Funding in Lithuania

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Capital Investment Funding in Lithuania

Executive Summary

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INTRODUCTION

This research is aimed at describing and assessing the capital investment funding mechanisms in Lithuania. Thus it consists of two parts: inventory and assessment. While the first part includes a description of investment distribution mechanisms and investment figures, the second is focused on evaluating the impact of the programs on regional development. Only those programs or instruments are analyzed which have a direct or implied impact on the reduction of regional disparities within the country. The assessment is based on their compliance with the principles of concentration, additionality, partnership, programming and transparency.

In this research *concentration* is the priority given in its distribution to the correction of inter-regional disparities; *additionality* shall mean co-financing between levels of government, socio-economic partners and/or final beneficiaries; *partnership* is consultation arrangements between levels of government and socio-economic partners in identification, design and implementation, linked to *subsidiarity*, the assignment of responsibilities to the lowest efficient level; *programming* means compatibility with coordinated multi-sectoral development strategies and *transparency* is the clarity and availability of criteria and procedures for allocations.

The following governmental programs are analyzed in this research:

1) The State Budget, including the State Investment Program.
2) The EU Structural aid programs.
3) The Municipal Business Development Funds.
4) Other funds.

The State Budget, including the State Investment Program

Within the state budget, the general programs, the special programs and the State Investment Program are analyzed. Their status is defined, and the principles of funds' allocation outlined. While the state budget and the state investment program are both analyzed and described as investment allocation documents, special attention is given to specific components of the budget, i.e., business support programs, road maintenance and development program, as well as the special program for the closure of the atomic power plant in Ignalina.

The EU Structural aid programs

Within the EU Structural aid programs, research is focused on the EU structural pre-accession initiatives (ISPA, SAPARD, PHARE 2000 and PHARE 2001), as well as other PHARE supported initiatives, such as the small project facility.

The Municipal Business Development Funds

The municipal business development funds are described as a source of funding that may have an impact on strengthening territorial competition together with the formation of a business-friendly environment.

Other funds

"Other funds" include the Municipal Infrastructure Development Program, which includes loans from various international organizations and must be co-financed by the municipalities. Finally, the system of equalization of municipal revenues is described, albeit briefly.

1. REGIONAL DISPARITIES AND INVESTMENT CONCENTRATION

In this section, the research attempts to interconnect the objectives and mechanisms of investment allocation with regional disparities. It also tries to present a general theoretical overview to whether concentration of investment either in lagging regions or in centers of growth can make economic or social sense.

It is emphasized that the measurement of regional disparities in Lithuania has been firmly based on two major indicators—GDP per capita and unemployment. Living conditions, efficiency and others may also be used from time to time but they tend to have little impact on the identification of problem regions or the design of measures to tackle inequalities.

In terms of GDP per capita, discrepancies between Lithuanian regions are considerable and the trend suggests that this will further increase. In 1996–1999, difference in GDP per capita in the counties of Vilnius and Tauragė (the richest and the poorest respectively) increased by 2.4 times. In three counties out of ten (Tauragė, Šiauliai and Marijampolė) GDP per capita was below 75% of the national average, and another county (Panevėžys) will probably also soon fall into this category. According to the preliminary National Development Plan:

> There are substantial disparities in the distribution of GDP per capita in Lithuania. In 1997, in comparison with national share of GDP per capita (national average = 100), Vilnius county accounted for 121%, Klaipėda county 106%, and Panevėžys county 101% of Lithuania's average. At the other extreme, Tauragė county accounted for 65% of the average, Marijampolė county 79%, Alytus county 84%, Šiauliai county 87%, Telšiai county 88% and Utena county 90% of the national average. During the period 1996–1997, the share of GDP per capita increased in Vilnius (from 28.5% to 29.3%), Kaunas (from 19.5% to 20.2%) and Marijampolė (from 4.2% to 4.3%) counties. During the same period, the share of GDP decreased for Klaipėda (from 12.4% to 11.9%), Šiauliai (from 9.7% to 9.5%), Tauragė (2.6% to 2.3%), Telšiai (4.5% to 4.3%) and Utena (5.1% to 4.9%). These trends point to increasing regional disparities within Lithuania.[1]

In terms of unemployment, the 1999 data suggest that in three counties out of ten it was below 7.5% (Vilnius, Kaunas, Klaipėda), in two counties between 7.5% and 10% (Telšiai, Utena) and in the remaining five counties between 10 and 12.5%.[2]

In terms of gross earnings, in 1998 one county had 110% of the national average (Vilnius), three counties between 100 and 110% (Utena, Telšiai, Klaipėda), three counties between 90 and 100% (Alytus, Kaunas, Panevėžys), two counties between 80 and 90% (Marijampolė, Šiauliai) and one county between 70 and 80% (Tauragė).[3]

In 1998 the number of visitor nights per 1,000 residents was over 500 in the county of Klaipėda, between 150 and 500 in the counties of Vilnius and Alytus, between 75 and 149 in the counties of Utena, Kaunas and Šiauliai and less than 75 in the remaining counties.[4]

There are significant disparities in the distribution of FDI (foreign direct investment). In 1999 Vilnius county attracted about 61% of total FDI, Klaipėda county about 13.1%, Kaunas county 12.2%. The least amount of FDI was attracted by Tauragė and Marijampolė counties (0.3%), Utena county (1.4%) and Telšiai county (1.8%).[5]

The distribution of small enterprises (less than ten employees) per 1,000 people is also uneven (based on 1998 data). The greatest numbers of small enterprises are established in Panevėžys, Marijampolė and Telšiai counties (sixteen per 1,000 people). The smallest numbers of small enterprises are established in Alytus, Tauragė and Vilnius (10 per 1,000 people). Yet only an average of nine out of twelve small enterprises are active. The difference between established and active enterprises indicates the downturn of economic activity in certain counties. On average, three out of twelve small enterprises per 1,000 people are not active. This indicator is greatest in Marijampolė (8.7 enterprises per 1,000 inhabitants of 16/1,000 are not active), Utena (6.9/1000), Telšiai (6.4/1,000), Šiauliai (4.2/1,000) and Alytus counties (3.8/1,000). According to the enterprise survey of 1999, the greatest number of enterprises that increased their output during 1998 were based in Utena county (55.8%), Vilnius county (37.7%) and Šiauliai county (31.7%). However, with the exception of Utena county, compared with 1997, the number of enterprises that increased their output fell considerably.

There are substantial disparities in production sales. In 1997, 22.8% of all production was sold in Telšiai county (primarily due to the oil refinery), 21.3% in Kaunas county and 15.4% in Vilnius county. At the other extreme, only 0.7% of all production was sold in Tauragė county, 3.5% in Utena and Marijampolė and 5.8% in Alytus.

Thus, we can conclude:

1) In general, the development in the counties of Vilnius, Klaipėda and Kaunas predominates. The county of Vilnius enjoys a privileged position because of comparatively well-developed infrastructure, the status of capital city, the supply of skilled labor, the presence of amenities and conveniences that other regions may be (and, indeed, are) lacking. Klaipėda county enjoys the benefits of having a large port and related infrastructure; it is well established as a point for transit of goods. It may also boast of comparatively well-developed amenities and infrastructure, municipal services and skilled labor. However, the benefits are absorbed, and industrial clustering and the process of innovation take place primarily in the cities of Vilnius and Klaipėda and their suburbs. In fact, if the county of Vilnius is taken without the capital city, its macroeconomic indicators may be even worse than in most other counties, particularly owing to severe under development of the southeastern (ethnically Polish, Belarusian or Russian) parts of the country. These issues are, however, quite unlikely to influence regional development policy, since, resources being scarce, the government distributes its limited funds, if at all, on the basis of county level indicators only.
2) The poorest counties of Lithuania can be considered those of Tauragė, Marijampolė, and Šiauliai (in which a lot of industries closed, unemployment drastically increased and the overall situation deteriorated in 1999–2000). However, the counties of Telšiai, Panevėžys and Alytus have little to cheer either. The situation in the county of Utena looks comparatively favorable, but this stems from the high earnings from the Ignalina atomic power plant that will close in 2004. The multiplied effect on the county's economy of this power station is now considerable, and the county is likely to suffer greatly after its closure. Therefore a lot of donor support is already provided for this county in an attempt to cushion the expected social and economic shock.
3) Only the counties of Vilnius, Klaipėda and Kaunas have comparatively favorable economic development backgrounds and prospects, while in all other counties, and also outside the cities of Vilnius, Klaipėda and Kaunas, economic depression, high unemployment and low wages, lack of public infrastructure and skilled labor are common features. Indeed, it would be incorrect to say that these territories have

any potential to attract national or foreign investment, to form industrial clusters or to develop research and development enterprises. While the cities of Panevėžys and Šiauliai may have such potential, subject to significant efforts and investment, all other cities in Lithuania are predominantly rural.

In view of the fact that regional disparities do exist and tend to widen, the question arises whether the Lithuanian government responded appropriately to the situation by introducing specific financial instruments. Our conclusion is that, while regional development plans must be drafted under the Regional Development Act, they have little impact on material allocations. The most significant resources currently available are those of the state budget and of the EU pre-accession aid. They are not, however, regionally focused, with the exception of PHARE 2000 and 2001 Economic and Social Cohesion initiatives, which were targeted at specific regions because of particular political circumstances that no longer exist.

Thus there are very few, if any, instruments of central government aid to lagging regions, with the exception of temporary and fragmented solutions. Moreover, it is noted that a clear preference of the government, even though it is not explicitly recognized, is to promote the development of "growth poles" by introducing nationwide grant schemes or investing comparatively high shares of funds in their public infrastructure.

It is also apparent that regional development attracted more attention in 1999–2000 than now. The reason for this would appear to be an incorrect interconnection of national regional development policy with EU structural aid. Since the EU structural aid is called "regional policy" there was much confusion about the real content of this term. In 2001, however, the understanding of the EU policy changed and so changed the material basis of regional policy. No longer supported from the EU structural pre-accession initiatives, this policy became more a declaration. The policy of support to specific regions was replaced by the policy to promote market development in all regions (which, in effect, means no real regional policy).

1.1 Programming

In the field of programming, the key issues addressed in the research are the coherence of national and regional development planning documents. A broad conclusion can, however, be offered that there is little coherence in some fields. The lack of coherence is reflected in the following facts:

1) While the Regional Development Act requires each county to draft its development plan, the procedure for drafting the state budget or the state investment program does not include a stage at which these plans could be considered. Only

the submissions from the county governors are considered. These submissions are, however, related exclusively to direct administrative competencies of county governments (which are quite limited).

2) While the National Development Plan is re-drafted each year, its designation is confined to the EU Structural Funds only. These funds shall be available when Lithuania accedes to the EU. Until that time, the Plan is treated as an exercise. It may, however, have a great impact on allocation of EU PHARE resources, but has limited impact (if any) on allocation of ISPA and SAPARD resources.

While the weaknesses outlined above are quite apparent, there were recent steps taken towards the strengthening of the connection between the state budget and various other documents. The reform of the budgetary structure implemented in 2000–2001 brought together many off-budget programs that were previously not monitored by the Ministry of Finance. The reform also resulted in including all non-returnable international aid to the state budget. As a result, the coherence of spending within the state budget is strengthening. There is, however, still little coherence between regional and national development programs. In fact, these programs have little impact on actual spending and only the submissions to the state budget (which should theoretically be based on strategic activity plans and sector development programs) matter.

From a theoretical point of view it is noted that very frequently development plans and programs are too general and may have little impact on development. The fact that most advanced countries do not have national development planning or acquired it only recently, as well as the fact that in many such countries regional development policy appeared only recently, is very telling.

1.2 Partnership

The research has come to the conclusion that the principles of partnership are observed only in EU-funded programs. The municipalities or social partners do not have the possibility to comment on the draft state budget or the state investment program. Neither do they have a possibility to intervene in the allocation of resources outside their direct competencies.

However, this is not necessarily to be taken as negative. It is acknowledged that there are too many different interests at stake that may prevent the government from conducting far-reaching consultations. At the same time, it is recognized that local governments or even social partners may intervene in the process of budget planning if the intervention has a sound basis.

At the same time, it is noted that in the EU-funded programs the principle of partnership is fully observed. The EU's officials require that extensive consultations be undertaken. Since programming for EU structural funds exists for a limited period of two years only, and since the major documents are now considered a part of an "exercise," the system has not yet included full-scale consultations. While it is likely that they will be conducted in the near future, they are currently more limited in scope (but still impressive compared to other governmental programs).

1.3 Additionality

The principle of additionality is assessed in the light of both co-financing of international aid by all national sources (including central government, municipalities, private partners) and co-financing of central government initiatives by the municipalities.

A broad conclusion is that the principle of additionality is strictly observed with respect to EU-structural aid. At least 25% of co-financing (in many cases 50%) is required by the EU from Lithuanian public sources, and in addition to that, private contributions are expected in case aid is directed to private enterprises. While private contributions to public investment initiatives may also be expected, they are very rare so far.

Some components of additionality have also recently been added to the various initiatives of the national government. For example, co-funding shall be required from the municipalities, the projects of which are included in the state investment program. Co-funding is also foreseen in the Municipal Infrastructure Development Program.

1.4 Transparency

It is recognized that the principle of transparency is generally observed in all major government investment programs. This may take various forms. The state budget and the state investment program are transparent *ex post*, i.e., full texts and quarterly (sometimes monthly) implementation reports are published on the Internet. Little transparency is observed at the draft stage—even central government institutions are not always able to obtain draft copies of these documents. The lack of *ex ante* transparency can be well justified and understandable, since the administrative burden on the Ministry of Finance is high and conflicts of interests at the stage of drafting would multiply if the ministry decided to expose the draft budget to open criticism.

The EU structural aid programs are *ex post* transparent, although most transparent is the SAPARD program—the SAPARD Plan is published on the Internet site of the Ministry of Agriculture, and much information on project profile and selection is provided. Less information is available on PHARE—although respective documents are also published on the Internet, the information is more fragmented. ISPA projects are the least transparent (although environmental projects are more transparent than the transport projects). This is, at least partly, because ISPA transport projects are targeted at large national initiatives and are of less concern to potential beneficiaries (the Ministry of Transport can be considered the main or even the only beneficiary in some cases).

The publication also provides the general assessment of transparency in other (smaller) programs.

2. EVALUATION AND CONCLUSIONS

While regional disparities in Lithuania are widening, in reality the recognition of the necessity of regional policy is lip service rather than actual implementation. It is, however, doubtful whether such policy could be economically feasible.

The interconnection between various regional and national development documents is still weak or at the initial stages of strengthening. However, the coherence between various national investment programs has been considerably strengthened during the last couple of years.

The partnership arrangements are very strong for EU aid. Since these amounts are considerable, they may or already do have an impact on general investment planning and implementation practice in the country. However, partnership arrangements are usually weak in the state-funded programs. This may well be justified.

The principle of additionality is firmly applied to EU structural aid. In a few other programs it has been introduced very recently.

The transparency arrangements are strong enough both in state and municipal investment documents and in the documents for EU aid. In some cases, however, *ex post* transparency at the stage of implementation (rather than *ex ante* transparency at the stage of drafting) is preferred.

ENDNOTES

1. Supra.
2. The data in this passage is based on The Regions of the Baltic States (2000), Nordregio Report.
3. The data in this passage is based on supra.
4. The data in this passage is based on supra.
5. The data in this passage and the passages below is based on the Preliminary National Development Plan, 1999.

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ANNEX

Table A5.1
Evaluation Table

Investment Program	Approximate Amount (p.a.), [EUR]	Concentration	Programming	Partnership	Additionality	Transparency
State Budget	3,000,000,000	3	4	3	1	4
State Investment Program	300,000,000	3	4	3	2	4
ISPA	50,000,000	4	3	4	5	3
SAPARD	30,000,000	4	4	4	5	4
PHARE ESC	14,000,000	3	2	3	5	3
PHARE SPF	1,000,000	4	4	4	4	4
Municipal Business Support Funds	1,600,000	3	2	2	1	3

Grade 5—max. compliance

Grade 1—min. compliance

Amount p.a.—the amount foreseen in 2002 or the most recent data available.

Capital Investment Funding in Poland

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Capital Investment Funding in Poland

Executive Summary

Mieczyslaw Bak, Przemyslaw Kulawczuk, Anna Szczesniak

INTRODUCTION

In 1990 Poland began the process of transformation towards a market economy. The process of decentralizing public finances accompanied the transformation of the economy and introduction of democracy. In 1990 the first level of self-government was established and local communities and municipalities began operating in Poland. The new territorial entities received concrete tasks and were equipped with different financial resources to supply needs identified by performance analysis. In 1999 the second phase of administrative reform was introduced. Two new levels, self-governing counties and regions, were introduced with new tasks and competencies. Poland now has relatively experienced local governments and two new levels of self-government that have begun to build their knowledge and skills to perform tasks previously undertaken by central state authorities.

The research conducted by the Institute for Private Enterprise and Democracy was aimed at the preparation of an inventory of capital investment funding mechanisms in Poland and evaluation of these mechanisms from the point of view of the five main principles of EU structural fund implementation: concentration, programming, partnership/subsidiarity, additionality and transparency. The full inventory is contained in the country report. The executive summary presented below focuses on how capital investment funding mechanisms fulfill EU principles and especially how they contribute to reducing regional disparities in a prospective member country. It is hoped that this will facilitate the future development of the use of structural funds in Poland.

1. CONCENTRATION

1.1 Regional Policy in Poland in the 1990s

The starting point for regional policy in the 1990s was a system of 49 medium-sized administrative regions and over 2,800 communes. In 1990 self-governing communities and municipalities replaced administrative communes but 49 administrative regions remained. These regions were still fully dependent on the central government. As the result of the political change in the first part of the 1990s the central government economic policy focused on economic transformation. In the mid-1990s the awareness of regional issues increased with regard to expanding regional disparities. Large, inefficient state factories built in the 1950s and 1960s suffered problems connected with low competitiveness. The massive process of decommissioning the “old industries” began the process of de-industrialization of less developed regions. In the second half of the 1990s, economic development primarily centered on five or six metropolitan areas that boomed thanks to a strong inflow of intellectual capital and foreign investment. The disparities between urban and rural areas increased significantly.

At this time public debate took into consideration two types of administrative reforms that would better enable the running of regional policy in Poland. Model A suggested changing the 49 administrative regions into self-governing regions. Regional policy would thus be carried out through small regions. Model B proposed to resort to the model of counties and larger regions. The latter was victorious. The initial number of twelve large regions was changed to sixteen as the result of strong lobbying pressures. In the years 1997–1998 the strongest legislative effort was placed on the preparation of administrative reform and on listing the competencies and financing sources of the new self-government units.

1.2 Main Sources of Capital Investment Funding in Poland at Local Level

Different units effect capital investment at local and regional levels in Poland. The most important are local governments and infrastructure enterprises. In this chapter we have not presented any commercial capital investment except for infrastructure development. It means that the presented values are lower than in reality because various commercial expenditures were not taken into account.

The data presented in the report comes mostly from the year 2000. The situation concerning 2002 year is presented in a more detailed way. Dynamic data are presented in parallel and all data are given in current prices. To tackle the problem of inflation, data were re-counted in ECU or EUR on the basis of the exchange rate of the Polish zloty (PLN) on the last day of the given year. This simplification allows for the presentation of data comparative to those used in the European Union. Table 6.1 shows changes in capital expenditures of local governments and infrastructure companies within the period 1993–2000.

Table 6.1
Capital Investment Domestic Expenditures of Local Governments and Infrastructure Companies in Million PLN and ECU/EUR (Current Prices) in the Period 1993–2000

Capital Investment Expenditures	1993	1994	1995	1996	1997	1998	1999	2000
Local governments	2,435	3,364	4,658	7,056	9,680	8,176	12,562	13,532
ECU/EUR equivalent	1,018	1,131	1,473	1,983	2,496	1,991	3,013	3,497
Supply of electricity, gas, heat and hot water, water supply and purification	3,570	4,869	6,768	8,770	10,026	10,255	10,606	9,138
ECU/EUR equivalent	1,492	1,637	2,140	2,464	2,586	2,497	2,544	2,361
Post and telecommunications	1,482	1,723	2,590	3,938	6,474	8,402	9,446	10,320
ECU/EUR equivalent	619	579	819	1,107	1,670	2,046	2,266	2,667
TOTAL domestic in M PLN	7,487	9,956	14,016	19,764	26,180	26,833	32,614	32,990
ECU/EUR equivalent	3,129	3,347	4,432	5,554	6,752	6,534	7,823	8,525
Exchange rate PLN/EUR	2,393	2,974	3,162	3,558	3,877	4,107	4,169	3,870

Source: Ministry of Finance, Main Statistic Office.

The data included in the above table show that within the period of 1993–2000 capital investment expenditures of local governments and infrastructure companies increased by 172.5% in EUR values. An especially rapid increase was observed in the capital expenditures of local governments (by 243.5%). The increase of capital investment in supplies of electricity, water, gas heat and sewage purification amounted to 58.2%. The increase of capital investment in post and telecommunications amounted to 330.9%. The presented data show that capital investment expenditures used for local and regional development increased significantly. For 2000, the total approved PHARE assistance for Poland amounted to 484 million EUR.[1] This assistance constitutes around 5.7% of total developmental expenditures at local levels in Poland. However, not all EU assistance had a regional character. The presented data show that local governments and infrastructure companies in Poland have significant financial potential for capital investment. Table 6.2 presents capital investment expenditures of local governments and the sources of their financing in 2000.

Table 6.2
Capital Investment Expenditures of Local Governments and Estimates of Financing Sources in Poland in 2000

Item	[Thousands PLN]	[%]
Capital Investment Expenditures	13,532,028	100.00
Sources of Financing	—	—
Own Revenues	4,421,580	32.65
General Subsidies	3,735,690	27.61
Allocations for Capital Investment*	2,717,510	20.10
Long-term Bank credits*	1,647,637	12.18
Long-term Loans*	502,868	3.72
Municipal Bonds*	227,494	1.68
Surplus form Previous Years	161,981	1.21
Other Incomes	107,144	0.79
Privatization Incomes	8,437	0.06
Sales of Securities	1,687	0.01
Total Sources of Financing	13,532,028	100.00

SOURCE: Ministry of Finance and own estimations.

* Incomes with dedicated direction of spending.

According to data included in the above table, the primary source of local governments' capital investment financing was their own revenues. On the basis of IPED estimates, own resources financed 32.65% of all capital investment. The second source of financing was general subsidies (coming from the central budget and supporting own revenues). This financed 27.61% of total local government capital investment in Poland in 2000. Both sources had non-dedicated directions of spending. Debt instruments accounted for 17.58% of capital investment financing in 2000. Of these, a critical role was played by bank credits. The other sources of capital investment financing were much less important. Table 6.3 shows the data on per capita capital investment expenditures.

The data presented in Table 6.3 show that communities (municipalities) in two regions have the highest average capital investment expenditures per capita. These are Mazovia (which includes Warsaw) and Lower Silesia (Wrocław). Other regions have expenditures below the average. The lowest per capita capital investment is observed in the rural Lubelski, Opolski and Warminsko-Mazurski regions and the heavily industrialized Silesia. Across the counties, the highest per capita expenditures are observed in Pomerania (57.3 PLN), Saint Cross (51.9 PLN) and the lowest in Kujawsko-Pomorski (19.9 PLN). The discrepancies between cities with county rights throughout the regions are not as significant. Of these, the highest per capita expenditures are observed in Pomerania (476.8 PLN) and the lowest in the neighboring Warminsko-Mazurski Region (216.2 PLN).

Table 6.3
Capital Investment Expenditures of Local Governments per Capita in Poland in 2000 [PLN]

Region (Capital)	Population	Communities/ Municipalities	Counties	Cities with County Rights	Regions
Lower Silesia (Wrocław)	2,975,074	317.5	37.6	442.6	38.2
Kujawsko-Pomorski (Toruń)	2,101,068	210.7	19.9	335.9	12.7
Lubelski (Lublin)	2,233,271	172.7	33.1	243.0	25.5
Lubuski (Zielona Góra)	1,023,829	232.4	26.5	474.0	37.0
Łódzki (Łódź)	2,647,783	205.2	33.0	253.5	6.6
Małopolski (Cracow)	3,226,611	201.9	34.1	408.5	27.0
Mazovia (Warsaw)	5,068,677	543.0	25.7	378.1	16.7
Opolski (Opole)	1,086,608	181.6	27.4	407.2	14.3
Podkarpacki (Rzeszów)	2,127,859	218.7	47.9	342.2	16.1
Podlaski (Białystok)	1,222,011	208.5	46.9	293.7	17.3
Pomerania (Gdansk)	2,194,628	247.0	57.3	476.8	24.0
Silesia (Katowice)	4,857,848	187.1	34.4	296.5	71.1
Saint Cross (Kielce)	1,323,719	217.2	51.9	300.1	75.6
Warminsko-Mazurski (Olsztyn)	1,466,248	190.6	41.5	216.2	11.0
Wielkopolski (Poznan)	3,357,541	259.0	28.2	339.5	19.6
West Pomerania (Szczecin)	1,733,446	269.3	37.7	388.8	13.9
TOTAL	38,646,201	277.6	34.8	342.8	28.5

SOURCE: Ministry of Finance.

Huge differences were observed in capital investment expenditures at the regional level of self-government. The highest per capita expenditures were observed in Saint Cross (75.6 PLN) and Silesia (71.1 PLN). The lowest expenditures were observed in the Łódzki Region (a mere 6.6 PLN per person). The massive differences among regions are mostly based on the fact that new regions were created only one year before the beginning of the analyzed period. The presented data show that differentiation in effecting capital investment among regions within particular groups of local governments is not so significant. However, it is necessary to realize that the analyzed data are average data. Real differences between communities, counties and cities are much higher.

1.3 Changes in Regional Disparities

In the first part of the 1990s central governments somewhat neglected regional policy issues and concentrated on more pressing issues of economic transformation. The only equalizing mechanisms in place were as follows:

- General subsidies mechanism;
- Local government borrowing;
- Capital investment in infrastructure companies;
- State agency donations, preferential loans and grants;
- Moderate foreign aid.

Any concrete or objective framework did generally not cover the functioning of these mechanisms and thus the results of their implementation were neither collated nor assessed. In reality, the extent to which each local community managed to use the last four mechanisms listed above depended mostly on the entrepreneurship and political connections of the community mayor. Commercial interests also hamstrung an important part of capital investment. Therefore the results of the functioning of the mentioned mechanisms are extremely diverse.

Changes in regional disparities were measured in four areas: regional incomes, infrastructure, environment quality and employment. Table 6.4 shows the changes as presented in relation to eleven variables and two statistical measures: GINI index and decile ratio.[2]

Table 6.4

Changes in Regional Disparities in Poland in 1990–1998

Analyzed Statistical Variable	GINI		Decile ratio	
	1990	1998	1990	1998
Total capital investment in 49 regions [in zlotys]	33.4	46.4	9.0	57.3
Average monthly wages in 49 regions [in zlotys]	3.3	5.1	1.3	1.7
Labor income in 49 regions [in zlotys]	31.0	34.6	7.2	19.5
Density of roads/per 100 sq. km	18.0	18.4	3.3	4.3
Stationary phone subscribers/1,000 inhabitants	15.0*	11.3*	2.7*	3.1*
Untreated waste water in hm^3	64.3*	49.0*	91.5*	96.5*
Reduction of air pollutants—particulates [%]	4.2*	3.5*	1.4*	1.3*
Reduction of air pollutants—gases [%]	72.7*	30.2*	531.0*	418.5*
Unemployment ratio [%]	16.0	18.2	3.1	7.9
Employment in particular regions [in thousands]	28.4	29.6	5.9	14.1
Employees/1,000 inhabitants	3.8	6.1	1.3	1.7

SOURCE: Own computations on the basis of data of the Main Statistic Office. * 1991.

The basis for the comparison was a group of 49 administrative regions. This group better illustrates regional disparities than the currently used twelve large regions.[3] The selection of the categories for analysis was due to data availability. According to the conducted research it was possible to reach the following conclusions:

1) Distribution of capital investment throughout Polish regions was carried out in a way that increased disparities and inequality amongst regions.
2) Positive changes were observed in the areas of infrastructure that fell under the responsibility of local governments and commercial companies: water supply, water treatment and communications—in these areas regional disparities were reduced. With respect to roads, where state authority prevailed, disparities increased.
3) Positive changes were observed in reducing pollution and regional disparities decreased. This was mostly due to the reduction in "dirty production" and environmental investment by companies. The National Fund for Environmental Protection also had a positive effect.
4) Significant growth in regional disparities was observed in labor incomes and employment. Weak regions became weaker in both fields, leading to increased social problems. The position of the strongest regions became stronger with respect to wages and remained unchanged in terms of employment levels. As a result, economic disparities amongst Polish regions increased.

Surprisingly despite the general reduction of regional disparities in infrastructure, economic disparities amongst regions significantly increased. It is possible that infrastructure improvement was too weak a factor to attract commercial investment, business and employment to rural and less developed areas. The state became even more centralized (the government liquidated seven out of nine large regional commercial banks), and the headquarters of numerous important companies were moved to the capital. The headquarters of significant financial institutions can only be found in four regional capitals (Cracow, Katowice, Wrocław, Warsaw). Through the process of mergers and acquisitions, government action and market forces, the headquarters of regional banks moved to Warsaw from Szczecin, Gdańsk, Lublin and Poznań. Two of the aforementioned regional capitals were located in so-called problem regions.

The concentration of wealth in large metropolitan areas creates problems for provincial and rural areas as well as for metropolitan areas (mass transportation and traffic). The present regions do not constitute homogenous territories with prevailing similarities thus making regional policy, especially equalizing or reducing disparities, more difficult. It is therefore necessary to conduct sub-regional policy within regions. To achieve this the Main Statistics Office created a new category of 44 sub-regions. In reality these are merely a statistical convenience, although sub-regions may be used for conducting policy aimed at reducing regional disparities.

Equalizing mechanisms in capital investment funding in Poland allowed for significant improvement of infrastructure in rural and less developed areas; but the sectoral policies of the government through the 1990s, together with close relations between business and politics at the central levels, facilitated centralization of the economy, labor market and incomes.

1.4 Evaluation of the Principle of Concentration

The fulfillment of the concentration principle in regional policy can be understood either as development and implementation of regional or local development programs or the introduction of development initiatives through fragmented sectoral mechanisms. De-concentration of regional development can be understood as a preference for public investment in areas of economic growth or as increasing the incapacity of poorer areas to exploit the availability of investment funds to meet co-financing requirements.

Through nearly all of the 1990s, de-concentration mechanisms were stronger in the areas of income and employment distribution. Parallel to this, total capital investment disparities increased. However, capital investment funding mechanisms reduced infrastructure disparities amongst regions. This was especially visible in water supply, availability of telecommunications and the reduction of environmental pollutants. Capital investment funding mechanisms functioning in relation to infrastructure decreased disparities, but government economic policy, especially in the area of privatization, mergers and acquisitions moved business headquarters from the provinces to larger cities and from the larger cities to the capital. It is worth noting that foreign investors preferred the larger cities for the location of the company headquarters, despite the fact that labor costs were significantly higher. In general, business preferred to remain close to the political authorities and numerous firms and banks originally opened in the provinces were subsequently moved to the capital in order to be closer to contracting units. As a result, regional disparities in the distribution of income and employment opportunities increased.

2. PROGRAMMING

Regional policy in the first years of economic transformation was not the most important target of government policy. The only mechanisms reducing infrastructure disparities functioned at the level of communities and municipalities. The possibility of Poland's accession to the EU changed the approach of governments towards regional policy from spatial issues to the issue of equalizing economic levels and reducing regional disparities. Thus it can be said that the EU had a very positive impact on changing the approach of Polish governments to regional policy. The educational role of current regional policies of EU countries removed the dominating naïve ideological point of view that any governmental intervention spoils market mechanisms and regional development ceased to be a subject for conflict amongst political parties.

The period 1997–1999 was devoted to administrative reform aimed at introducing two new levels of self-government. In accordance to the needs of the reform, new legislative acts, which described the tasks and competences of the new levels, were introduced. These acts stated that the regional policy of all entities responsible for regional policy should be carried on the basis of strategic development plans. After the implementation of administrative reform, two years were dedicated to the preparation of strategic development plans by the new self-governments and the national government.

At the national government level the first significant document concerning regional policy was prepared in May 2000. Parliament passed the Act on the Principles of Supporting Regional Development. The Act provides that supporting regional development is aimed at:

1) Development of different areas of the country, improvement of living standards and the level of need satisfaction of local communities,
2) Creating conditions to increase the competitiveness of local governments,
3) Equalizing differences in the level of development of particular areas of the country; equalizing the opportunities of citizens regardless of area of domicile and reducing the backwardness of less developed areas that have less favorable development conditions.

The Act also defines the main tasks in the running of regional policy. According to the Act the role of supporter is played by the central government and roles of beneficiaries by regional and local governments.

In November 2000 the National Strategy of Regional Development 2001–2006 was prepared. The preparation of the strategy was enforced by the requirements of EU integration. The strategy listed the following objectives:

1) Increase the average level of GNP per capita in relation to the EU average from 38% in 1999 to 47% in 2006. The regional minimum should amount to 33% of the EU average and regional maximum to 71%;
2) Acting against excessive increases in regional disparities through the reduction of unemployment and stimulating the potential of less developed areas;
3) Training of staff in central and regional administration in the effective implementation of regional policy, co-financed by the EU;
4) Utilization of administrative reform for increasing the pace of development. Increasing the value of own revenues of local governments and reducing public resources;

5) The strategic objective is to create conditions for increasing the competitiveness of regions and to act against the marginalization of less developed regions in order to support long-term economic development, social, economic and territorial cohesion and integration with the EU.

The strategy provided that the main activities that should be adopted for fulfilling the above objectives should focus on: the development of infrastructure, restructuring and diversification of the regional economic base, supporting human resources development in problem areas, providing cooperation between regions (cross-border, transnational).

It was provided in the strategy that the list of areas requiring support would be created in special support programs, which would be adjusted to the financial possibilities of the state. The National Strategy will be carried out in two phases: before accession to EU and after accession. The Council of Ministers provides the general coordination of the strategy but the Minister of Economy is responsible for strategy implementation. In tandem, Regional Steering Committees were created to coordinate the implementation of particular regional strategies. All regions prepared the regional development strategies that constitute the basis of state regional policy.

The implementation of regional policy described in the Act and National Strategy is in the initial stage. According to the Act, regional contracts were awarded to regions and in 2001 the first regional projects were started. However, the size of these projects and financial allocation for this purpose is still far ahead of regional development needs.

When analyzing the programming principle in the distribution of capital investment funds in the country, it is necessary to answer the following questions:

1) How far is public investment subject to territorial cross-sectoral development strategies?
2) How much impact have Regional Operating Programs and similar regional development plans had on actual public investment?

To answer these questions it is necessary to underline that regional self-governing units have been operating since 1999. They have very little experience in regional development. In spite of this fact, a significant part of developmental funds went through territorial units in the 1990s. It included the following areas:

- *Communal infrastructure*: water supply, sewage purification, roads (partly through territorial and partly sectoral approach; since 1999 the regional approach has increased);
- *Supply of gas, electricity and telecommunication services* through commercial infrastructure companies (partly privatized) which had regional character (electricity supply) and national entities (the remainder);

- *Labor market development funds*: up to 1998—sectoral approach, since 2000—regional approach;
- *Education*: regional approach up to 1998 primary education, since 1999 also secondary education;
- *Health*—basic services regional approach up to 1998, since 1999 all medical services;
- *Business development*: up to 1998—sectoral approach, since 1999 mixed sectoral and regional approach.

The above list indicates the increasing role of the regional/local approach in directing development processes in Poland. Unfortunately, the visible weakness of all levels of self-governments constitutes a shortage of operating programs that would follow the preparation of strategies. The advancement of the preparation of the regional/local operating programs (plans) backed by financial resources is very low. Most territorial units do not have detailed development plans but only general strategies. The only detailed plan they have to prepare is the local/regional budget act, which specifies incomes and expenditures of local/regional government. Sometimes they prepare a capital investment plan, but it is subordinated to the one-year budgetary bill. Polish law prohibits communities to plan budgetary income and expenditures for more than one year. Incomes of territorial units vary from year to year with regard to changing legislative regulations (they change every year), and it is very difficult to plan expenditures in the long run. Polish local and regional units have a vision of what they want to do, but they do not have operating programs to attain this vision. Planning and programming is a serious weakness of regional and local units.

Important steps were taken in 2001 when the first regional contracts were concluded for years 2002–2003. In these contracts the central government promised to finance regional development undertakings (including capital investment). However the shortage of budgetary funds caused plans to be extended to 2004. It means that yearly financial support was cut by a third. It also means that the pace of advancing regional development projects was significantly cut.

3. PARTNERSHIP/SUBSIDIARITY

The principle of partnership and subsidiarity in the area of capital investment process can be understood as involvement of regional or local institutions and stakeholders in the selection, design and execution of public investment programs. It often raises the following question:

To what extent are: (1) regional institutions, (2) local governments and (3) "socio-economic partners" associated by and with national governments in the selection, design and execution of public investments in:

1) local infrastructure,
2) income/employment promotion,
3) human resource development?

When answering this question it is possible to conclude that:

1) All capital investment executed by local governments met the principle of partnership with the exception of small allocations for capital investment which, to some extent, could be put down to political tensions and choices (especially roads and bridges). They are financed from the own revenues of the self-governments, local governments borrowing and only rarely by allocations from the central government (20.1% in 2000). Besides, receiving all possible types of allocations requires close cooperation and planning at the local level;
2) Sectoral donations of governmental agencies met the partnership principle especially in the area of funding environment improvement programs. Other governmental agencies distributed their resources directly to the beneficiaries with little input from local or regional governments;
3) Most of local infrastructure capital investment met the principle of partnership in full. The lowest level was in roads (especially national roads);
4) Service fees based infrastructure investments were executed on the basis of satisfying customers' needs. This reflected in full the principle of partnership;
5) Employment promotion was transferred from central government to regional entities in 2000. However with regard to the increase of unemployment and the reduction of funds for employment promotion, the real possibilities to carry out policy in this area were reduced;

In Poland strategies for regional and local development are prepared by self-governments. Self-governments are created by elections. In most regions the winning parties create regional executives, and in all other regions executives are created by coalitions. In Poland strategic development principles take into consideration preferences of stakeholders, but in reality capital investment projects that receive financing are the result of political lobbying for executing particular projects. With regard to the poor condition of roads and bridges in Poland the highest preference is given to improvement in this area. However, such investments are extremely costly and the other objectives are satisfied by regional contracts at a very low level. To some extent regional authorities may decide to issue bonds but this process is in its infancy.

A different situation exists on the level of municipalities and communities. They have more functioning programs and can influence more effectively when and what should be carried out in the area of capital investment. Spending of regional governments constituted about 5% of spending of total local and regional governments in 2000. The rest were local and county governments. Local governments are very active on the bond market and are able to design and plan more capital investment than regional authorities.

Considering the importance of local government spending on infrastructure investment one may say that funding mechanisms created by local self-governments tend to be efficient. Local governments budgets need to secure the funding for covering the costs of their tasks and later they may decide on the level of capital investment on the basis of local needs. A relatively small amount of capital investment funding is decided by the national administration in the form of donations for designated local investment projects. [4] Local governments, especially those authorities that elaborated local development strategies are more familiar with local needs and preferences. Also, they tend to spend the funds more efficiently than national authorities and have more opportunities to build public-private partnerships to execute investment projects. All these factors contributed to greater efficiency in Poland's regional funding mechanism.

Changes related to implementation of the self-government counties and regions in 1999 increased the scope of funds distributed on a regional basis. Efficiency of regional funding mechanisms led to the transfer of part of the sectoral investment to regional level and regional contracts replaced partly central investment programs. Those changes allow for better adjustment of investment programs to local needs. Regions, with the participation of municipalities/communities, counties and social partners prepare local development strategies, which include the most important investment projects necessary for economic development. Regions, within the framework of regional contracts, obtain the funds to cover part of the cost of planned investment expenses that were previously distributed on a sectoral basis.

4. ADDITIONALITY

Co-financing contributions to public investment funds made by self-governments or final beneficiaries seem to be a very important issue. The ability of co-financing influences the possibilities to attract new capital and new donors. It requires an answer to the question: How far do investment programs funded by donor or national budgets require co-financing by: (1) regional governments, (2) municipal governments and (3) final beneficiaries?

In Poland there are different mechanisms to support infrastructure capital investment. They are mostly based on the assumption that capital investment expenditures are made mostly from the financial resources (or borrowing) of the beneficiary or local government and the role of governmental agencies is to support or subsidize these efforts. The repayment of loans should come from utility service fees. The role of governmental agencies is to leverage individual efforts of local communities and other regional entities. The general rule in providing assistance funds is that interest-subsidized loan instruments are rather easily accessible while donations are rather more difficult to receive. The levels of support are very diversified in the same agencies in relation to particular instruments. For example the National Fund for Environmental Protection provides subsidized interest loans up to 70% of the value of the project, while donations cannot exceed 30%. Both instruments can of course be used in tandem. Under specified conditions 50% of loans could be redeemed (when a project is completed on time). The operation of the National Fund is an example of the logic of how additionality is provided in Poland.

Another issue is the problem of how differences in the revenue bases of regional and local governments affect their ability to co-finance and access public investment funds. Important considerations are: How far are such resource disparities ameliorated by: (1) general equalization systems or (2) differences in co-financing ratios and other requirements?

In Poland, mechanisms to equalize incomes for local and regional governments are provided through the general subsidies mechanism. General subsidies are direct transfers from the central budget to communities, counties and regions. (General subsidies are considered as an addition to the own revenues of local governments and can be used for all competences).[5] In communities, general subsidies are counted separately for three divided sections: fundamental, educational and compensation. The fundamental part contains mechanisms aimed at equalizing the diverse tax power of different communities. Therefore fiscally weaker communities are supported. In counties and regions general subsidies consist of three parts: educational, highways and equalization.[6] There are different percentage formulae used for counting general subsidies for each kind of unit; the most important factor is the number of citizens living in each unit.

1) Each community receives a general subsidy consisting of three independent sections: fundamental, educational and compensation;
2) The fundamental section forms 1% of total planned incomes of the central budget;
3) From the total sum of general subsidies 4% is subtracted as central reserve;
4) Each community with tax incomes less than 85% of the average tax incomes per person in the nation receives 90% of the difference between per capita amounts (given and the average);
5) The remaining amount is divided amongst all communities in relation to the number of citizens;
6) The educational part of the general subsidy is established as 12.8% of the total planned central budget incomes and divided according to rules established by the Minister of Education. These rules are based on complicated formulae including such factors as number of students and former expenditures;

7) Similar equalizing rules exist in relation to counties and regions;
8) Equalization in counties and regions is effected through the equalization section of the general subsidies.

In spite of the fact that the general subsidy is created using three different mechanisms, there is no detail on the purpose of transferred funds. Local governments are obliged to fulfill all their tasks (originated from the particular self-governance acts for each level of local government). However, it is not stipulated what part of general subsidies should be spent on current expenditures and what part for capital investment.

Low income local and regional entities are also provided for by low interest loans. The interest rates are determined in relation to the bill of exchange rediscount rate (Berr) announced by the National Bank of Poland. In the case of a loan granted to the Capital City of Warsaw and to Warsaw local communities, the interest rate of 0.5 Berr p.a. is applied; in the case of rural counties the interest rate is 0.2 Berr p.a.; whereas in cities with county rights it is between 0.1 and 0.5 Berr p.a. depending on the total budgetary income per inhabitant. The total income of the county and the municipality/community is calculated as the income in the budgetary year, two years previous to the year under consideration. The interest rates on loans granted to municipalities and communities is between 0.1 and 0.45 Berr p.a., depending on the total budgetary income per inhabitant generated in the budgetary year.

The main problems affecting capital investment from local governments incomes are low revenues compared to needs. Local authorities are obliged to cover current expenses related to the tasks described above, including salaries and other personnel costs. Besides the lack of sufficient funds, after covering current expenses some problems are created by the lack of development strategies and long-term investment programs. Strategies generally include the vision of the municipality, county or region for ten to twenty years. Elaboration of the strategy is not compulsory for the municipality and county and it is related to significant costs (10,000 USD and up).[7] Therefore only certain local governments elaborated development strategies. Municipalities also have limited knowledge on how to prepare long-term (four to six years) investment programs, which should include identification of investment needs and a list of investment priorities together with estimated costs. Lack of development strategies and investment programs for all local government units results in lower interest in capital investment and in lower effectiveness of such investments.

It can be stated that local/regional governments use the EU Structural Funds principles to some extent. Their legal duties and the situation of the particular community, municipality or region determine their criteria, procedures and decisions for investment spending. The whole process is more transparent and conforms to programming and partnership principles if the regional strategy exists. As it was stated above, this was not obligatory for the local authority.

Local government borrowing is considered as one of the quickest growing sections of capital investment financing of local governments in Poland and is potentially a successful source of co-financing. Accordingly to IPED estimates 17.6% of total capital investment of local governments was financed through borrowing, amounting to 2,378 million PLN. This amount was split between 1,648 million PLN of bank credits, 503 million PLN of non-bank loans and 227 million PLN of municipal bonds. These sums were calculated on the basis of yearly increases in borrowing; new credits minus repayments of old credits, non-bank loans (mostly from public target funds) and municipal bonds (new issues minus repayment of old issues). Local government borrowing is one of the potential sources to increase opportunities to satisfy the principle of additionality and provide sources for backing EU funds.

The 1998 Public Finance Act defines local government borrowing in Poland. The Act provides that the deficit of local governments' budgets should be covered from: sales of securities issued by local government, bank credits from Polish banks, loans, privatization incomes and any surplus from previous years. The Act provides that the ratio of repayments of credits, loans and other similar sums should not exceed 15% of the planned annual incomes of the local government and 12% when total public debt is higher than 55% of PNB. Another provision of the Act is that the total debt of local government should not exceed 60% of the total planned budgetary incomes for the given year. Apart from these provisions there are no real obstacles to local government borrowing. At the end of 2000 the total debt of local governments constituted 12.9% of their incomes. It means that, according to the Act, there is significant potential for further indebtedness. The above-mentioned ratio differs according to the different units of self-governments. Cities with county rights have an average debt/income ratio of 17.3%, communities/municipalities 14.8%, counties 3% and regions 2.8%. Regions and counties were created only from January 1, 1999 and these low ratios are due to their short period of operation. With regard to the fact that cities with county rights took over some tasks from central government administration, it caused their incomes to increase significantly from 1999 onwards and thus increased their borrowing possibilities.

Notwithstanding that future obligations to provide own resources for development projects are undecided, there is little doubt that either through own resources or (more probably) through borrowing, local and regional governments will be able to fulfill the principle of additionality in accepting EU funds.

5. TRANSPARENCY

According to IPED estimates most funds for capital investment (above 90%) are distributed on the basis of criteria that are open, clearly defined and publicized. Most public fund applications/competitions are published on the Internet and information is freely available to applicants and suppliers. Another issue is the execution of the competitions. Occasionally, participants complain about the actual execution of the competitions, but in general they are based on the Public Procurement Act of 1995 (revised).

The Law on Public Finances of November 1998 plays an important role in providing transparency in public spending. The law specifies the procedures for the budget construction. Projects of the regional/local budget should be prepared by the unit board and sent to the Regional Accounting Chamber, which supervises finances of regional/local authorities, no later than the end of November. The opinion of the Chamber should be presented to the local council, which accepts the budget in the form of a resolution. The whole procedure of passing the Budget Resolution should be completed by the end of the year; in some special cases this can be extended to the end of the following March. The local/regional council *(Rada* or *Sejmik*) has limited possibilities to implement amendments; it cannot introduce changes that decrease revenues or increase expenses without acceptance of the local government board.

The budget also specifies long-term investment programs, including details of all planned programs. A supplement to the Budget Resolution should describe the investment program, its objectives and tasks to be financed from the budget, name of the administrative unit responsible for the program, time schedule and total current cost of the program and its cost over the next two years. Budget resolutions in the following years should include the necessary financial resources for the programs' execution and timely accomplishment. Investment programs can be reduced or postponed by resolution of the local/regional parliament.

According to Polish law, investment spending, like all other spending, should be made efficiently—achieving the best results compared to expenditure and in a way that allows for the timely accomplishment of the investment program and fulfillment of its obligations.[8] The last statement is especially important for companies involved in local authorities' investment programs. According to the law, investment programs should not begin if insufficient funds are available for its execution; in practice this has not always been the case.

In Poland investment expenditures by public units should be made on the basis of the Law on Public Procurement. According to the last amendments to the law only relatively low expenditures, up to 3,000 EUR, are excluded from the tender procedures. Companies executing larger investment contracts should be selected in open tenders. If the investment contracts do not exceed 30,000 EUR the contractor can be selected by "limited tender," where only a selected number of organizations are invited. This procedure can be also applied if the specific character of investment limits the potential number of interested and competent companies. If the open tender procedure fails, special two-phase tenders can be organized. During the first phase companies can provide the offer without price. During the second phase negotiations are conducted with a limited number of companies. In case of the tender being canceled due to the lack of sufficient offers, tender procedure can be replaced with negotiations, assuring competitive conditions.[9]

Committees, composed of local administration representatives, assess the offers of the companies interested in participating in the public procurement process. In many cases, the lack of experience of its members creates problems with selection of the most appropriate offer, thus leading to lower effectiveness of public spending on investment at local and regional level. However, in general, all local, regional and central authorities obey procurement procedures both in fund distribution and in selecting companies to execute the orders. Respect for public procurement rules is considered as a matter of critical importance by both units submitting offers and the public.

A more difficult situation exists when the problem of allocations from central budget is concerned. Serious doubts appear when central government allocations are used for effecting capital investment, which is considered the task of local governments (they should be covered from general subsidies according to the general rules). The criteria included in the Act of Incomes of Local Governments states:

- Allocation may not exceed 50% of the total cost of capital investment (80% in education and 75% in high unemployment units);
- Unused allocations should be returned.

Unfortunately, apart from the above criteria, there are no provisions considering eligibility, maximum sizes of allocations, procedures of applying, selection criteria, etc. It means that criteria are discretionary and strongly dependent on the political will of parliament and the central government. Some authors maintain that allocations financing the "own-tasks" of local governments require political decisions.[10] In this context such allocations could be considered as awards for electoral support. The only positive side of such target donations is the fact that they cannot be used for other purposes. The examples of such allocations are allocations from the central budget for building a new line of the Warsaw metro or allocations to build the bridge on the Vistula River in Gdansk. In spite of the fact that most of such allocations absolutely meet the rationale of public spending, without doubts these expenditures are strongly influenced by political pressures.

Ex post formal control on the fairness of capital investment spending is executed at all levels of governments. This control is performed internally (by local governments) or externally (by regional accounting offices and the Highest Chamber of Control). However, external control is performed rather sporadically.

Typically, monitoring and evaluation processes are seldom organized; local and regional authorities rarely use monitoring and evaluation as the instrument for introducing improvements in procedures or process and skills in this area are limited. Moreover, participatory monitoring and evaluation of capital investment are not performed.

6. EVALUATION

Table 6.5
Evaluation of Capital Investment Funding Instruments in Compliance to Structural Funds Principles in 2000 for Local and Regional Development and Estimation of the Value Ratio as a Percentage of GDP

Capital Investment (CI) Funding Instrument	Type of Principle-score					Value Ratio as % of GDP
	CON	PRO	PAR	ADD	TRA	
Infrastructure Companies Expenditures for Capital Investment	5	5	4	4	5	2.841
Own Revenues of Local or Regional Governments (LG) spent on CI	4	4	5	5	5	0.646
LG General Subsidies spent on CI	5	4	5	5	5	0.545
LG Allocations for Capital Investment from Public Funds (mostly Environmental)	4	5	5	5	5	0.397
LG Allocations for Capital Investment from the Central Budget for own Tasks of Local Governments	3	2	1	1	1	
LG Long-Term Bank Loans for CI	5	5	5	5	5	0.241
LG Long-Term Public Funds Loans for CI	5	5	5	5	5	0.077
LG Municipal Bonds for CI	5	5	5	5	5	0.033
Other Incomes of Local and Regional Governments spent on CI	4	3	3	3	5	0.040
PHARE Program 2000 (M 484 EUR)[11]	4	5	5	5	5	0.273
SAPARD Program 2000 (M 171.6 EUR)[12]	4	5	5	5	4	0.097
ISPA Program 2000 (M 312 EUR)[13]	4	5	5	5	3	0.176
Regional contracts (started in 2001)	4	4	5	3	5	0.390[14]
Sectoral allocations for CI from the State Budget	2	2	1	1	2	1.236

SOURCE: Team estimation on the basis of the report findings and statistic data. Explanation: CON—Concentration, PRO—Programming, PAR—Partnership, ADD—Additionality, TRA—Transparency. The value of GDP in 2000 = M 684,926 PLN (M 176,983 EUR).

SCORES: 5—very high performance, 4—high, 3—moderate, 2—limited, 1—poor.

ENDNOTES

1 It does not mean that this amount was spent on local capital investment.

2 GINI—value in points equal to measured area between the diagonal line of equality and the Lorenz curve, divided by the area of the triangle under the line of equality, multiplied by 100. Decile ratio—the share of labor income (and other similar categories) received by the richest tenth of the regions divided by the share received by the poorest tenth of the regions. In the report eleven variables were estimated.

3 To avoid problems in analyzing regional differences in the present twelve large regions, the Main Statistic Office divided Poland into 44 sub-regions in 2000.

4 In 2000 it was 91.5 million EUR.

5 In the executive summary regulations for 2000 are presented. Unfortunately methods of counting general subventions change very often.

6 The fundamental and educational parts of general subsidies are subordinated to real budgetary incomes. Because central budgetary incomes are fluctuating, it is necessary to change local budgets many times in the fiscal year.

7 It is however compulsory for regions.

8 Law on Public Finances, November 26, 1998 with further changes, §27 p.3, 2001.

9 Law on Public Procurement with changes dated June 22, 2001, Dz.Ust nr 76, 2001.

10 E.g., Zyta Gilowska.

11 Appropriation.

12 Appropriation.

13 Appropriation.

14 Estimation of 2001 ratio.

Capital Investment Funding in Romania

Afrodita Popa

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INTRODUCTION

Purpose of the Analysis

Special importance is attached to regional development in the decentralization process that started in the countries of Central and Southeastern Europe after 1990; there are three main reasons for this:

- Allocation of funds for investments to poorly developed regions, for reducing regional disparities;
- Economic development involves a series of factors and measures, starting with infrastructure development, stimulation of the labor market, environmental protection, which are more easily treated at a regional level;
- Regional structures are the most likely to develop the measures of public private partnership necessary for economic development and growth in a market economy.

The study intends to make an analysis of the funds for financing capital investments in Romania aimed at contributing to regional development.

In the current study the capital investments have been divided into three main components:

- infrastructure,
- promotion of economic activity,
- development of human capital (funds for labor market development).

The funds for capital investment financing will be analyzed according to their source:

- The European Union,
- The state budget,
- Off-budget revenues,

- Local public administration revenues,
- Revenues from local administration loans.

Methodology

This analysis is based on the information supplied in the study "Funding of Capital Investments in Romania."[1] The study makes a presentation of the current and potential development policies, with a detailed description of the role of the institutions involved in the process, and presents a list of the funds for funding capital investments in Romania according to the source of origin and destination.

The analysis makes a detailed evaluation of the funds for financing capital investments in Romania on the basis of the following criteria:

- Concentration (allocation of funds for alleviating regional disparities);
- Programming (compatibility and correlation with multi-sectoral development strategies);
- Partnership and subsidiarity (partnership between the levels of public administration and the private sector in identifying and establishing investment priorities);
- Additionality (co-financing of priority programs);
- Transparency (of the criteria and procedures of fund allocation).

The study also makes a comparative analysis of the funds for financing capital investments in Romania, according to the source and amount.

Limitations

This study does not intend to make a comparison regarding the allocation of funds for capital investments on a sectoral or regional basis, nor to analyze the efficiency of the various approaches to fund allocations.

Therefore, no comparative analysis will be made of the effects resulting from sectoral allocation versus regional allocation of funds for capital investment. The information included in this study can, however, be included in any such analysis.

Similarly, it is not the objective of this analysis to supply alternative solutions for a more efficient allocation of the capital investment funds or for the increase in their impact in the medium and long term.

1. CURRENT REGIONAL DEVELOPMENT IN ROMANIA

In the period 1998–1999, with PHARE assistance, a complex institutional framework was created. Its aim was to attain the regional development goals laid out in Law 151/1998 on regional development in Romania, with the observance of the principles and procedures according to which allocation and management of the Structural Funds are made in the EU member states, in particular the Regional Development European Fund.

In 1997 PHARE had a component of institutional development, which with technical assistance, contributed to the drafting of Law 151/1998 and laid the basis for capacity-building to prepare Romania to manage Structural Funds. As a result the following institutions were set up: The National Council for Regional Development (NCRD), the National Agency for Regional Development (NARD), the Regional Development Councils (RDC) and the Regional Development Agencies (RDA).[2]

At the end of 2000, NARD was incorporated into the new Ministry of Development and Prognosis.

With the introduction of regional structures in Romania eight regions of five to six counties were created (Figure 7.1).

The main goal of regional development policy, as formulated in Law 151/1998, is "narrowing of the existing regional disparities, in particular by stimulating balanced development and accelerating the recovery of those zones that are lagging behind in point of development due to historical, geographic, economic and political circumstances and the prevention of new disparities and regional imbalances."

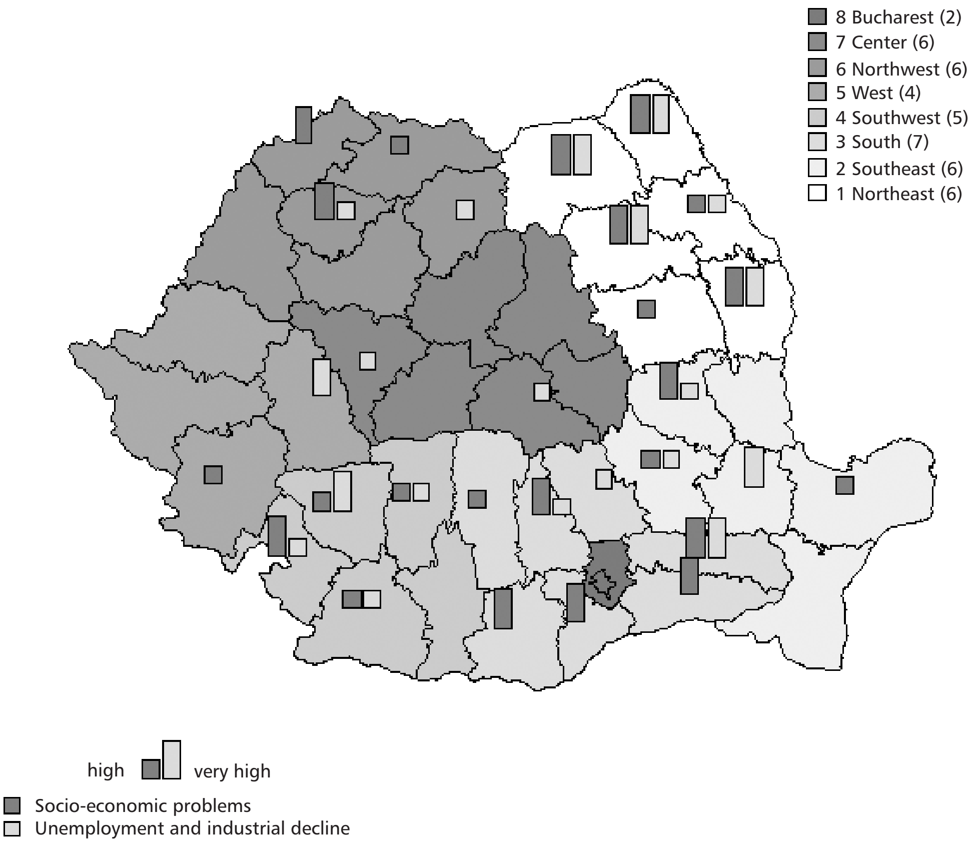
Not all the regions have the same level of development.[3] Thus, Region 1 Northeast is facing the most serious problems, both from the social and economic viewpoint and as regards the level of unemployment and industrial decline.[4] Regions 3 South and 4 Southwest face very serious problems also. The best situation, in socio-economic industrial terms, is found in Bucharest and Regions 7 Center and 5 West.

In spite of all this, the inter-regional gaps are not the biggest problem in Romania. The most important problem is that of intra-local disparities within the counties themselves.

Thus, the inter-county horizontal imbalance calculated as a ratio of total local budget revenue per capita is maximum 2:1. The intra-county imbalance is over 5:1 in the case of rich counties and about 2.5:1 in the case of poor counties.[5]

The municipalities that are county seats, which in most of the cases have fewer than 30% of the county population but utilize most of the financial capacity, often over 80%, explain the big intra-county imbalances. The main cause is that the services offered by the local public administrations, which through related taxes and fees generate these revenues, are not homogenous. The municipalities that are county seats and the bigger towns offer a wider range of services than the small localities or the localities in rural areas.

Figure 7.1
Development Regions in Romania



2. THE FLOW OF CAPITAL INVESTMENT FUNDS

In this section the funds for capital investment in Romania will be analyzed according to the following criteria:

- Concentration,
- Programming,
- Partnership/Subsidiarity,
- Additionality,
- Transparency.

Concentration refers to the promotion, with priority, of public investments for the socio-economic development of under-developed areas.

In order to see whether capital investments observe the principle of concentration, the following elements will be considered:

- Does allocation of investment funds aim at reducing intra- or inter-regional discrepancies?
- Does the regional development policy have the same goal?
- Is the allocation of investment funds made on a regional or sectoral basis?

Programming refers to the inclusion of capital investments in multi-sectoral development strategies. An analysis will be made of the flows of capital investment from the angle of the regional or sectoral approach.

Partnership/Subsidiarity refers to the involvement of all stakeholders (at a central, regional and local level) in establishing the priorities of capital investment and their development. We shall analyze to what extent the stakeholders at a regional/local level are involved in capital investment decision-making.

Additionality refers to the co-financing of the capital investment programs funded through external and/or governmental funds by the local governments and/or final beneficiaries.

The following elements will be analyzed:

- To what extent do investment programs financed by external or governmental funds need local co-financing?
- To what extent do the differences in local financial capacity affect the possibility of accessing EU funds?

Transparency refers to the clarity and availability of all the information in the financing programs, the selection and evaluation criteria and the procedures of allocation of funds for capital investment.

2.1 Concentration

Seen in a wider European perspective, the disparities in the level of revenues (as an indicator of the level of development disparities) are a phenomenon with profound economic and social implications. Thus, as the average level of the GDP per capita in Romania is 22% of the European average, the Bucharest-Ilfov region (RDA 8) attains 38.5% of the European average (at purchasing power parity) while the Northeast region (RDA 1) reaches only 20% of the European average.

It is important to notice that besides the Bucharest-Ilfov and Northeast regions, which represent exceptions, all the other regions of Romania have similar average levels of revenues, in the overall context of a slightly higher level of development in the western part of the country as compared to the east.[6]

In formulating regional development policies, two National Development Plans (NDP) were drawn up.[7]

- NDP 2000–2002, designed as an instrument through which to prepare the technical and financial procedures necessary for the use, as of 2000, of the PHARE pre-accession financial instruments, ISPA and SAPARD;
- NDP 2002–2005, in which are defined seven priority axes around which all the objectives, measures, programs and projects that will contribute to the achievement of these major priorities are articulated.

For NDP 2000–2002, in conformity with the Memorandum on Financing, the investment projects had two domains:

- The component for industrial restructuring and development of human resources (15.5 M EUR) with co-financing from the Romanian government (National Pre-Accession Fund of 3,875 M EUR).
- The component for rural development of 2.5 M EUR and co-financing of 0.625 M EUR that was developed in partnership with the former NARD and the Ministry of Agriculture, Food and Forests.

The investment projects in the component of Industrial Restructuring and Development of Human Resources were implemented in all the eight development regions, the initial allocation being equal. The projects had three goals: local initiatives, tourism development and human resources development.

The approach to drafting the NDP for 2002–2005 is similar in approach although the content and role of the NDP has evolved to encompass a deeper economic and social analysis made at sectoral and regional level.

The priority axes, as defined in NDP 2002–2005, are:

- *Axis 1.* The development of manufacturing and related services sector, strengthening of competitiveness of economic activities and promotion of the private sector;
- *Axis 2.* Improvement and development of infrastructure;
- *Axis 3.* Consolidation of human resources potential, of the capacity of the labor force to adjust to market requirements and improvement of the quality of social services;
- *Axis 4.* Support for agriculture and rural development;
- *Axis 5.* Protection and improvement of the quality of the environment;
- *Axis 6.* Stimulation of scientific research and technological development, innovation, communication, IT and the creation of the information society;
- *Axis 7.* Improvement of the economic structure of the regions, support for balanced and sustainable regional development.

The sectoral and regional financial programming was made in close connection with the drafting of the 2002 State Budget and the budget orientations for 2003–2005, so that it includes objectives, measures and programs that contribute to the achievement of national development priorities.

In order to concentrate activities and decrease inter-regional disparities, eleven priority targets or Industrial Restructuring Zones, were identified in seven of the eight Development Regions.

Table 7.1 shows the funds allotted for regional development (the three components that are the object of this study), according to their source. It should be mentioned that no accurate comparison could be made on the volume of funds according to the source, since the data refers to different years (2000 for local budget funds and 2000 and 2001 for EU funds, government and beneficiaries contribution). Furthermore, some of the funds (local budgets funds) have already been disbursed, others (EU, government and beneficiaries) only pledged.

The funds allocated for financing local public administration capital investments differ from one region to another. The main differences are the capacity of the local governments (LGs) to mobilize own resources for capital investment and the volume of funds allocated for this purpose from the state budget.

Thus, in 2002 the biggest volume of capital investments financed from LG sources belonged to RDA 2, and the smallest to RDA 1 (RDA 8—Bucharest will not be taken into consideration in this comparative analysis because it is a unique position and the results could be misconstrued).

Within these funds, the funds allocated from the state budget and from off-budget sources have been predominant in some RDAs, but not necessarily the poorest ones.[8] Thus we can draw the conclusion that the funds transferred from the state budget to the LGs for financing capital investments and those coming from off-budget sources are not distributed according to the criterion of correcting intra-regional gaps.

A comparative analysis of 1999 and 2000 shows that in most cases the investment funds, regardless of their source, have risen in absolute value. In relative value, owing to inflation, these funds have diminished.

The line-item budget of LGs does not allow for the separation of investments into the three main components analyzed in this study; therefore the analysis of compliance with the principle of concentration by types of investments cannot be made, at least when referring to investments whose financing source is the local public administration.

As to the investment funds allocated through the pre-accession instruments the following can be mentioned:

- The EU funds for the Promotion of Economic Activities have been relatively fairly distributed across the eight development regions; the funds from the state budget were also regularly distributed (the funds allocated in 2000 and 2001), with a maximum for RDA 6 (poor region) and a minimum for RDA 3 (average

Table 7.1
Funds Allotted for Regional Development According to Their Source

		Local Budgets (Disbursed 2000)		PHARE 2000, FNDR 2001 (Pledged)		State Budget (Pledged for PHARE 2000, FNDR 2001)		Own Contributions Beneficiaries (To be Disbursed for PHARE 2000, FNDR 2001)	
Source of Funds	**Population**	**Total [EUR]**	**EUR/Capita**	**Total [EUR]**	**EUR/Capita**	**Total [EUR]**	**EUR/Capita**	**Total [EUR]**	**EUR/Capita**
Destination									
RDA 1 (NE)	3,786,066	40,345,588	10.66	23,086,250	6.10	9,309,418	2.46	95,000	0.03
RDA 2 (SE)	2,983,028	52,954,665	17.75	17,506,250	5.87	6,552,750	2.20	1,475,335	0.49
RDA 3 (S)	3,499,272	40,803,548	11.66	15,456,250	4.42	5,869,417	1.68	0	0.00
RDA 4 (SW)	2,423,059	27,314,324	11.27	2,493,750	1.03	1,548,584	0.64	0	0.00
RDA 5 (W)	2,068,149	26,688,946	12.90	7,343,750	3.55	3,165,251	1.53	0	0.00
RDA 6 (NW)	2,864,034	36,326,562	12.68	15,163,508	5.29	5,771,836	2.02	0	0.00
RDA 7 (C)	2,654,843	29,432,146	11.09	6,993,750	2.63	3,048,584	1.15	0	0.00
RDA 8 (B)	2,291,528	78,197,889	34.12	2,493,750	1.09	831,250	0.36	0	0.00
Total	22,569,979	332,063,667	14.71	90,537,258	4.01	36,097,093	1.60	1,570,335	0.07

region). Funds that will be allocated through PHARE 2000 and NFRD 2001 are distributed in a more balanced way.

- The funds destined for human capital development follow the same pattern: relatively regularly in 2000 and 2001, with a maximum much beyond the average at RDA 6; the funds that are to be allocated through PHARE 2000 and NFRD 2001 are distributed with priority for RDA 1, RDA 2, RDA 3 and RDA 6 (adequate for the poor regions).
- The funds destined for infrastructure investments, that appeared for the first time as a distinct component starting with PHARE 2000 are concentrated especially on the poor regions (RDA 1, RDA 2, RDA 3, RDA 6), regardless of their source (EU, state budget).

This analysis shows that as of 2000 the principle of concentration of funds is being applied.

Table 7.2 presents the volume of funds disbursed or pledged, as of 2000–2001, according to the source. The funds from EU (PHARE and ISPA) include also the contribution required from the Romanian government and/or final beneficiaries.

Table 7.2

The Volume of Funds Dispersed or Pledged, According to Source, 2000–2001

Local Budgets		PHARE 2000, FNDR 2001		ISPA 2000–2001	
Total [EUR]	EUR/Capita	Total [EUR]	EUR/Capita	Total [EUR]	EUR/Capita
332,063,667	14.71	128,204,686	5.68	1,210,977,498	53.65

Analyzing the volume of funds/capita, in Romania, it can be easily noticed that the biggest volume of funds is allotted on a sectoral approach (ISPA, components of environment and transport) as compared to the funds allotted on regional development criteria, i.e., through PHARE and local budgets (for the latter, the approach is more local).

2.2 Programming

In 1999–2000 the National Development Plan (NDP) was drafted and approved, including financial planning for the period 2000–2002. It includes the strategic priorities of development for the period 2000–2002, for which Romania requires financial assistance from the EU (achieved through the PHARE, ISPA and SAPARD instruments), as well as the priorities that, in addition to community assets, are to be financed from internal and other external resources.

This has been the first programming document drafted under the conditions of a market economy and achieved both on the basis of information from the field, by means of the Regional Development Plans drawn up by the Regional Development Agencies and the plans and strategies drawn up at a national level by the various ministries and institutions involved in regional development.

In the NDP 2000–2002, nine priorities were defined, out of which six are national priorities of regional development and three are national priorities of sectoral development.

No evaluation can yet be made of the amount of funds allocated for regional versus sectoral development, but according to the number of priority measures defined by the NDP, the approach was prevailingly regional.

In drafting the regional development plans that formed the basis of the NDP, a systematic and detailed analysis was made of the problems identified in every region. Thus, priority objectives were established for every region as well as measures aimed at tackling current problems.

However, drafting of the regional development plans was not carried out on the basis of priorities defined by local governments. This is because most LGs do not have concrete development or implementation priorities. The priorities are scattered, and the funds are insufficient to simultaneously carry out the necessary investments in infrastructure.

There was neither coherent strategy, at a regional level, for remedying intra-regional gaps nor any balanced strategy for all-sector development.

As for the drafting of the NDP 2002–2005, several stages of consultations have been covered, both with the ministries and with the Regional Development Councils, through their executive bodies—the Regional Development Agencies (RDA). For the first time meetings were organized between the ministries and the Regional Development Councils through the RDA.

Sectoral and regional financial programming was made in close connection to the drafting of the State Budget for 2002 and with the budget provisions for 2003–2005, so that it includes objectives, measures and programs that go hand in hand for the achievement of the national priority axis of development.

The NDP 2002–2005 specifies the financing sources of these priorities. Thus, the NDP 2002–2005 is not only a programmatic document that highlights the priorities and measures related to the accession to the European Union but also an instrument that underlines what types of financial resources (State Budget, PHARE, ISPA, SAPARD, other sources) will be used for the implementation of these measures.

There is no articulated multi-sectoral approach in programming capital investments. Major importance has been attached first to the sectors where the differences compared to the requirements regarding conformity with the EU directives are largest. Thus, a large amount of funds will be channeled to the environment and transport infrastructure programs, with ISPA co-financing.

In establishing the regional development priorities there is no consideration of the fiscal capacity of LGs, and there is no coherent policy and strategy for remedying intra-regional disparities. In this respect, a policy could be designed to differentiate the local contribution to programs with an impact at an economic and social level. Following a fiscal policy of diminishing the horizontal imbalances should aim to remedy intra-regional disparities in the long run.

All this leads to the conclusion that allocation of funds for capital investment is made in relation to the priorities defined in the NDP (regional or sectoral) and therefore in observance of the principles of programming, with the rider that priorities at a regional level do not take into account intra-regional disparities.

Moreover, although most of counties draw up development plans (according to the legal provisions in force), they are not always taken into consideration when drafting the regional development plans and are almost never implemented or correlated with the local budgets.

2.3 Partnership and Subsidiarity

An analysis of institutional relations regarding capital investment flow shows the following:

- The strategies, programs and priorities are defined at a central level; it is also at a central level that the implementation agencies and/or payment agencies for the programs financed through structural funds are to be found;
- The regional level is responsible for defining regional priorities (by consultation with the LG and the private sector in the region), for the selection of the projects financed through structural funds according to the priorities defined at a central and regional level and for their monitoring and evaluation;
- At a local level there are fund beneficiaries whose task is the implementation of the projects financed through structural funds; more often than not they are not consulted about the needs and priorities at the local level when drawing up regional strategies.

With the drawing up of the NDP, and especially of the NDP for 2002–2005, observance of the principle of partnership has been considered, at least between the central and regional level.

The planning activity in the NDP:

- Promotes interaction among ministries;
- Supports cooperation among ministries, regional bodies and local governments;
- Improves free access to information—as a part of the consolidation of the civil society and promotion of an “information society”;

- Leads to growing transparency in the process of drafting the development strategy and programs of Romania.

All the above are requirements of the European Union, particularly for accessing Structural Funds.

As regards the partnership between all the stakeholders interested in promoting a project, starting with the central level and ending with the local, often the partnership was a formal one and ineffectual, at least from the regional level down.

There is a partnership between the central administration and the regional level in identifying and establishing priorities. However, effective cooperation with local governments, and especially cooperation with the private sector, has not been considered or promoted. Conversely, the existing legislative framework restricts the connection between the public administration and the private sector to the issuing of licenses, permits and approvals. Furthermore, the local government does not generally take into consideration the needs of private investors in the process of drawing up local policies; there is little dialogue with the private sector regarding the necessities, priorities and lines of action for economic growth at a local level.

In conclusion, as regards partnership, partnership exists only between the levels of the public administration and the central/regional structures. Similarly, the principle of subsidiarity is observed up to the regional level, but these principles are not applied below the regional level.

As of 2002 the situation changed considerably, and special attention has been attached to the consultation and involvement of all the stakeholders interested in the decision-making process of establishing community priorities. Thus a wide process of consultations between the central and the local governments took place for the promotion of new pieces of legislation to settle the issue of local public finance in that year.

We can assume that, once started, this process will be expanded to the other domains as well, including the identification of priorities for capital investments.

The process will probably last several years, but the positive factor that we would like to mention here is that the foundations of a new culture of partnership are being laid in Romania, this time for real, not formally or imposed because of the requirements of certain programs with European funding.

2.4 Additionality

All the pre-accession instruments, which are actually the most important source of capital investment financing in Romania, require to a certain extent co-financing from the Romanian government and/or the final beneficiaries.

In the case of the bilateral agreements signed between the lending institutions and the final beneficiaries, the conditions and percentages of local co-financing vary from one program to another; however, they are not a major source of financing capital investments in Romania.

Sectoral and regional financial planning was made in the NDP 2002–2005 by identifying the financing sources: the state budget, including loans guaranteed by the state and the EU pre-accession funds; the contribution of the private sector to the development programs of Romania is also estimated. In this way there is level of coherence between the PHARE, ISPA and SAPARD funds and the planning of national investments and other national economic policies.

The procedures on the release of the financing installments are very well defined, and for any type of program of funding from the European Union the existence (and more often than not the release) of the tranche of local co-financing (be it governmental or the contribution of the beneficiary) is a pre-condition for receiving the EU grants.

What should be noted is that all the existing pre-accession instruments in Romania require a big contribution by the final beneficiaries. This hinders access to such instruments by the local governments with low financial capacity. A paradox is being created here: although destined for a harmonious regional development, the EU funds are accessible only to the local governments with a healthy financial situation and not to those with the greatest need.

On the other hand, neither the Romanian government nor the regional institutions have designed any mechanism to support localities with a perilous financial situation to access the pre-accession funds (e.g., by local shares to various programs with European funding, subsidies for infrastructure investments, an effective equalization system, loans with low interest rates, etc).

The fact that most of the localities with big infrastructure problems cannot ensure from their own budgets or from loans the co-financing contribution necessary for any type of capital investment program will lead to bigger intra-regional gaps.

The solution would seem to be that an articulated strategy and an efficient system of horizontal balances will lead to a reduction in intra-regional infrastructure disparities over time.

2.5 Transparency

On the basis of the National Development Plan, the MDP draws up every year a project chart that, following negotiations with the Ministry of European Integration, is sent for approval to the European Union. The Financing Memorandum is concluded on the basis of the project charts and is signed by Romania's government and the European Union. This Memorandum establishes also the implementation arrangements, the financial procedures (by reference to the EU or national regulations) and the co-financing obligations.

The procedures regarding selection of projects, contracting, monitoring, reporting, payment and control have been drawn up in conformity with PHARE-ISPA-SAPARD, EU Regulation, Romanian legislation and were approved by the NFRD, the MPF and the European Commission.

The selection procedures are transparent; the calls for proposals for the projects are advertised in the press, the information package is available on the Internet and all the RDAs. The press periodically informed the public concerned about the number of projects and the value of the funds allotted. The criteria of allocation and the results of the calls for proposals were made public in every RDA.

The criteria that underlay the allocation of funds were established together by the MDP, RDAs, the line-ministries and with the consultation of the civil society sector. They were approved in the NCRD.

The criteria and procedures for the allocation of funds, for every component of capital investments, are also made public. The priorities established in the NDP are widely covered by the media.

The RDAs have the obligation to make public all the information on any available line of financing and to put at the disposal of the potential beneficiaries all the information necessary for taking part on an equal footing in the calls for proposals for the projects.

The process is wholly transparent. What is still questionable is the method of establishing the selection criteria for the projects, which, especially is influenced by political factors at a regional level.

Similarly, it is not clear what is happening when there are insufficient funds for financing all the eligible projects. As for the projects financed through ISPA, a sectoral allocation of funds was made, and it can be assumed that all the projects identified as priorities in the respective sectors will be financed (because the project identification was made in a phase prior to the negotiation of the amounts allotted to Romania through ISPA). In the case of PHARE and SAPARD it is not clear what influences criteria selection from the eligible projects in case the total amount of funds necessary exceeds the amount of funds allocated.

3. EVALUATION

In this section we will evaluate the funds for financing capital investments according to the source of origin and their amount, according to the five aforementioned criteria.

The analysis is made on the basis of the data of 2000. As to the volume of funds from various sources, we should mention that the funds from the European Union, through various financing instruments, are the ones allotted in 2000, whereas the local funds (both those from the state budget and the own funds from the local budgets) are those effectively released and spent for capital investment.

For this reason the comparison is not relevant. The local sources for funding capital investments for co-financing of the European programs will be different in volume. Conversely, the low level of local sources in 2000 is closely connected to fiscal decentralization in Romania, within which new responsibilities were attributed annually to local governments, very often without allocation of the necessary financial resources, a fact that had an effect on the decrease in capital investment expenditures.

Therefore evaluation of funds for capital investment financing will be based primarily on the observance of the five criteria and only after that on the relation with the volume and importance of funds for every financing source.

In Table 7.3 we have given scores from one to five for each criterion, by financing source, with the following significance:

5—the criterion is fully fulfilled;
4—the criterion is fulfilled to the greatest extent;
3—the criterion is fulfilled to a sufficient extent;
2—there are several shortcomings in observing the criterion;
1—the criterion is not fulfilled.

Table 7.3
Assessment of Regional Funds in Romania

		Concentration	Programming	Partnership	Additionality	Transparency
EU	Phare	4	5	3	4	5
	ISPA	1	1	3	4	5
State Budget	Contribution to EU financed programs	4	5	3	5	4
	Transfers for investments to LGs	2	2	2	1	2
LG revenues	Own revenues for investments	3	3	1	1	4
	Off-budget revenues	2	1	1	1	2

It should be mentioned that for some of the financing sources, some criteria cannot be met (e.g., concentration for ISPA programs, owing to the fact that ISPA has a sectoral approach and the concentration criteria refers to a regional approach).

Additionality scored 4 points for EU-financed programs. As explained earlier in this document, the local resources required for co-financing these programs are in some cases too large to allow equal access to all LGs. As for the funds committed by the state budget as co-financing to the EU-funded programs, these totally fulfilled the additionality criteria.

The investments funded out of LG revenues scored lower because revenues for investment are very unpredictable and highly dependent on the resources needed for financing the regular responsibilities of LGs, and also because there exists no clear criteria for allocation of the off-budget revenues.

ENDNOTES

1 Report drawn up for the Local Government Initiative of the Open Society Institute (LGI), within the program Local Government Policy Partnership Fiscal Decentralization Initiative in 2002 by Afrodita Popa, Victor Giosan and Victoria Goldenberg Vaida.

2 The development regions are only institutional structures. The local public administration in Romania is organized on two levels: the county councils (the first level) and the local councils (municipality, town or village). There is no subordination between the two levels of local public administration in Romania. More details on the system of local public administration in Romania and the regional structures are supplied in the study "Financing Capital Investment in Romania."

3 See map.

4 The National Statistics Institute 1999 .

5 "Reduction of the discrepancies between the local budgets of various types of territorial administrative units by improvement of the transfers from the state budget to the local budgets" made by the FDI Technical Assistance project in the field of inter-administrative financial relations. The coordinators were Claudia Pamfil and Victor Giosan.

6 NDP 2002–2005.

7 More information on NDPs in Afrodita Popa, Victor Giosan and Victoria Goldenberg Vaida "Funding of Capital Investments in Romania," report drawn up for the Local Government Initiative of the Open Society Institute (LGI), within the program Local Government Policy Partnership Fiscal Decentralization Initiative in 2002.

8 Ibid.

ANNEX 1

Table A7.1
Institutional Responsibilities in Regional Development in Romania

Institutional Responsibilities in Regional Development in Romania		
Level	**Institution**	**Role in Regional Development**
Central Level	Ministry of Development and Prognosis (MDP)	Ministry of synthesis whose role is to draw up analyses and prognoses on the development of Romanian economy, to implement the government strategy and programs, to promote economic and social development policies as well as the foreign investment in Romania.
	Ministry of Public Finance (MPF)	Ministry with a role of coordination and synthesis. The General Directorate of Public Finance and State Financial Control (GDPFSFC) represents MPF in every county.
	Ministry of Public Works, Transports and Housing (MPWTH)	MPWTH represents the state authority in the field of railway, road, inland rivers, air transportation, multi-modal and combined, constructions and lay out of territory, that it exercises directly or by means of the special technical bodies, subordinated public institutions or authorized commercial companies.
	National Administration of Roads (NAR)	NAR is operating under the coordination of MPWTH; a regie autonome that is responsible for the administration of national roads and bridges through 7 subordinated regional directorates.
	The Ministry of Public Administration (MPA)	NPA is a ministry that is implementing the government's policy in public administration, the strategy for the development of public services of local interest.
	The Ministry of Labour and Social Solidarity (MLSS)	MLSS has the role to provide and coordinate the application of the government's strategy and polices in the field of labour, protection and social solidarity.
	The Ministry of Tourism (MT)	MT drafts and applies, on the basis of the government's program, the policy in the field of tourism, as a domain of priority in the national economy.
	The National Council for Regional Development (NCRD)	NCRD is a deliberative body, without legal standing, whose main role is to promote regional development policy in Romania.

Table A7.1 (continued)
Institutional Responsibilities in Regional Development in Romania

Institutional Responsibilities in Regional Development in Romania		
Level	**Institution**	**Role in Regional Development**
Central Level *(continued)*	The Ministry of Agriculture, Food and Forests (MAAF)	MAAF is a ministry involved in regional development issues.
	The Ministry of SMEs and Cooperation (MSME)	MSME is a ministry involved in regional development issues.
	The Ministry of Economy and Resources (MER)	MER is a ministry involved in regional development issues.
	The Ministry of Waters and Environment Protection (MWEP)	MWEP is a ministry involved in regional development issues.
	The Ministry of European Integration (MEI)	MEI is a ministry involved in regional development issues.
Regional Level	The Regional Development Council (RDC)	RDC is a deliberative body whose role is to coordinate the activities and promote the objectives of the policy of regional development.
	The Regional Development Agency (RDA)	Each development region is led by a RDA, responsible for drafting and implementation of the regional development strategy and programs; RDAs are not territorial-administrative units.
Local Level	County councils (CC)	CCs are territorial-administrative units—tier 1 of local government in Romania.
	Local councils (LC)	LCs are territorial administrative units (municipalities, towns and communes)—tier 2 of local government in Romania.

PART I

Conclusions: Decentralization and Regional Development in Pratice

Kenneth Davey

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Conclusions: Decentralization and Regional Development in Pratice

Kenneth Davey

INTRODUCTION

In the run-up to accession to the EU the debate over reform and development in the candidate countries has had a strong but often confused regional dimension. This has been encouraged by the EU and has had three interlocking strands:

- *Regional government*: the possible creation or reform of an upper tier of self-government both to complete the reforms of public administration begun in 1990 and to stimulate socio-economic development;
- *Regional policy*: the desirability of directing public investment and encouraging private investment to reduce the growing territorial disparities in levels of income and employment;
- *Regional development planning*: basing increasing proportions of public investment on regionally conceived and focused strategies and priorities rather than nationwide sectoral programs and targets.

The impact of this debate on the reform of public administration has been analyzed in a parallel LGI study by Gerard Marcou (ed.), *Regionalization for Development and Accession to the European Union: A Comparative Perspective*, OSI/LGI 2002.

The purpose of this study is to see how far it has influenced the actual flows of public investment. This will serve as a basis for discussing the actual significance of the regional approach to development.

The six country studies, summarized in the previous chapters, have analyzed public investment and evaluated it according to the EU's own regional development criteria of concentration, programming, partnership and subsidiarity, additionality and transparency.

This chapter compares the findings of the six studies under each criterion and then attempts to reach some general conclusions.

1. CONCENTRATION

To what extent, and in what ways has the funding of capital investment in the six countries given priority to disadvantaged regions and localities?

1.1 Disparities

In the early 1990s all countries were preoccupied with the loss of previous markets for their goods, services and produce and the resulting collapse of existing bases of employment; measures to shore them up or replace them with new products suitable for new, largely western markets were sought by all levels of government.

By the mid-1990s growing disparities between levels of employment and income in different regions and localities were emerging in the six countries and the gaps have continued to widen. In Lithuania, for example, the difference in GDP per capita between the richest and poorest counties grew by 240% between 1996 and 1999.

The growth in disparity arose partly from differences in the decay of the previous economic base. The environmental backlash against brown coal particularly affected mining areas such as Northwest Bohemia; the loss of Eastern European and Soviet Union markets for manufacturing goods particularly affected areas such as Silesia (both Czech and Polish) and Miskolc. Loss of Soviet Union markets for food crops particularly affected the Baltic States. The disappearance of protected markets particularly affected factories whose original location reflected no natural advantage.

It arose also from differences in ability to attract fresh investment. Foreign investment in sectors such as electronics and automobiles favored areas closest to western European markets, greenfield sites rather than existing industrial locations and proximity to motorways (particularly important because so much modern manufacturing is organized around widely dispersed production of components). In Hungary 80% of all foreign direct investment has been west of the Danube, (65% in Budapest), and in Lithuania 61% has been in Vilnius. Differences in economic performance feed through public revenues into infrastructural support. Local government capital expenditure in Warsaw Region has been three times greater per capita than in Lublin.

Discussion of regional policy and regional development tends to focus on interregional disparity in incomes and employment. To some extent this has characterized the experience of the countries studied. There have been broad differences between west and east in both Hungary and Poland; unemployment in the eastern Hungarian counties has been twice the national average. The west/east divide is even more pronounced in neighboring Slovakia (which is not covered by the studies). The economies of North Moravia and Northwest Bohemia suffered disproportionately in the Czech Republic.

The country studies are unanimous, however, in arguing that disparities between incomes and employment *within* regions are far more significant than those between them. In Romania disparities between regions are not very substantial, once the capital is excluded, but are very significant between large cities, smaller towns and rural areas. Statistical deviations at NUTS IV level greatly exceed those at NUTS II. In Lithuania, for example, the favorable rankings of Vilnius, Kaunas and Klaipeda counties disappear once the cities are removed from the measurement.

Generally, settlement size rather than regional location explains more of the difference in performance. This is partly because the collapse of pre-1990 markets was generally most injurious to collective agriculture and to the medium-sized mono-industrial town so favored by Soviet-era planning. Commuting extended urban unemployment to rural hinterlands. Larger cities are more resilient because of their diversity, their human resources, their attractions to service industry and the business infrastructure such as banking which is crucial to private enterprise. In Poland, for example, the consolidation of commercial banking has contributed towards the concentration of investment in five to six metropolitan areas.

Two caveats emerge from the country reports. Firstly, while gaps in income and employment may have been widening during the late 1990s, the poorer localities have not necessarily been getting poorer in absolute rather than relative terms. Unemployment in eastern Hungary is still twice the national average but it has more than halved in size since its 1993 peak. Secondly, some other disparities have been significantly reduced, such as access to public services like telecommunications, gas and piped, treated water. While inter-regional disparities in average incomes grew by 50% in Poland between 1990 and 1998, differences in telephone subscribers and treated water fell by similar margins.

1.2 Regional Policy

In 1990 regional policy generally had a bad name in Eastern Europe. It was associated with a rigid socialist style of regional planning that bequeathed at least three unwelcome legacies. The first was the small village which had been deliberately deprived of new development and infrastructure; secondly, the mono-industrial town, totally dependent upon a single factory which had no competitive advantage such as access to raw materials or good communications; the third was an excessive network of service institutions that were insupportable in the new fiscal climate.

In varying degrees, regional policy has re-emerged during the late 1990s, though on very different lines. There are at least three reasons for this. The first is growing consciousness of the disparities discussed in the previous section and political pressure to mitigate them.

The second reason has been the influence of the European Union and the growing pressure to qualify for membership and access to pre-accession and, ultimately, Structural Funds. As explained in Chapter One, the European Union sees regional development as important to the maintenance of "cohesion" and much PHARE funding and technical assistance have promoted creation of an institutional and procedural framework for it. This has also become part of implicit or explicit conditionality for accession to the Union. Other donors have also supported the Union's approach in a more random fashion, with pilot regional projects or associated training.

The third reason is neatly described in the Polish report, "the educational role of current regional policies of EU countries removed the dominating naïve ideological point of view that any governmental intervention spoils market mechanisms."

The result, particularly of EU pressure, has been the creation of an institutional framework for planning and implementing regional development. Typical components have been the re-establishment of a ministry responsible for regional development (often a haven for the remnant of Socialist-era regional planners), demarcation of planning regions, legislation on support to regional development, and formulation of a national strategy for regional development and regional plans (usually called ROPs—Regional Operating Programs). The Czech Republic, for example, created a Ministry of Regional Development in 1996, and in 2000 passed an Act on Support to Regional Development and a Regional Development Strategy supported by eight ROPs.

The EU's institutional model also includes a regional level of self-government capable of partnership in the design and execution of regional programs. This has added pressure to the establishment of supra-municipal tiers of self-government in the Czech Republic and Poland. However, only in Poland have these elected units fulfilled the EU's own requirements for the size of a NUTS II region. As a result combinations of self-governing regions or counties have actually formulated ROPs in the Czech Republic, Hungary and Romania, whilst the concept of a sub-national NUTS II planning region has been abandoned by the EU in the Baltic States.

Concern for the development of disadvantaged regions has been neither consistent nor consensual, however. Governments have tended to change hands after every electoral term in Eastern Europe with consequent changes in preference for interventionist policies. Regional policy only emerged in the Czech Republic in 1996 after the defeat of the ideologically pro-market government of Vaclav Klaus. In Lithuania "it is noted that a clear preference of the government, even though it is not explicitly recognized, is to promote the development of 'growth poles' by introducing nationwide grant schemes or investing comparatively high shares of funds in their public infrastructure." Growth versus equity is a live debate in Eastern Europe, and there are understandably people and parties who argue that inter-regional equity is an unaffordable luxury.

Moreover, EU policy has itself been ambivalent, particularly in the Baltic States. The decision to treat Estonia, Latvia and Lithuania as single NUTS II entities has been interpreted as "replacing a policy of support to specific regions with support to market development in all regions (which was no real regional policy at all)."

1.3 Concentration in Practice

Insofar as public investment has given priority to disadvantaged areas, how has this been affected?

The institutional development described in the previous section would suggest that such preferences would be implemented largely through comprehensive regional plans and programs. There are some examples of this approach, though as yet relatively few. PHARE has funded pilot regional development projects in three northern and eastern Hungarian counties and in Northwest Bohemia and North Moravia in the Czech Republic. In Latvia a Regional Development Fund has been significant in employment creation through business support and labor retraining. The 2002–5 Romanian National Development Plan allocates substantial funding to multi-sectoral investment in nine Industrial Restructuring Zones, spread across seven planning regions.

Such regionalized investment programs may play a larger part in the future, depending in part on the balance still to be struck between EU contributions to regional and sectoral operating programs. However, the principle of concentration has been more observable so far in the application of a regional bias to allocation of *sectoral programs*. For example, in the Czech Republic allocation of funds for support of small and medium enterprises (SMEs) and human resource development have been weighted by unemployment levels; a similar bias has been given in Hungary to funds for labor market and human resource development. In most countries the EU's SAPARD program is accessible to micro-regions with significant rural unemployment and agricultural market decline.

Finally, one traditional instrument of "concentration"—localized tax breaks—has been ruled out of court by EU accession requirements, based on single market, "level playing field" philosophy. Whether local tax exemptions do really promote sustained development is highly debatable, but the option is no longer open.

1.4 Impacts

The country studies have attempted to evaluate all capital investment flows according to their bias towards disadvantaged areas.

Clearly experience varies from country to country and over time. A few generalizations can be attempted:

1) Some concentration of investment in lower income/higher unemployment areas has been achieved by specifically regional programs, particularly the PHARE

pilot regional projects, and also by those sectoral business support and labor force development funds that are deliberately allocated for this purpose.
2) National programs in fields such as tourism, road development, business support, and industrial parks tend to have the opposite effect by favoring areas of faster economic growth; this is a function of their own internal logic.
3) A substantial proportion of all regionally located investment has been in environmental infrastructure—water supply, sewerage, waste management, etc.—funded by national environmental protection funds and by EU through ISPA. Distribution is normally based on the degree of inadequacy of existing provision plus local ability to meet co-financing requirements (which may include loan repayment). Allocation rarely has any specific relation to regional income and employment levels, and the co-financing requirements may even prejudice access by lower income localities. Nevertheless, such environmental investment does reduce gaps in the quality of life and may in the long term improve the economic attractions of the poorer localities.

2. PROGRAMMING

How far are the nature and location of public investment subject to territorial cross-sectoral strategies?

The EU's emphasis on programming stems from the conviction that regional deprivation can only be effectively tackled by a strategic approach that combines mutually supportive and interdependent actions. The quality of the infrastructure, the environment and the labor force will all be important to potential investors and to improve one without the others may be futile. Fragmented and uncoordinated programs may well be costly and inefficient.

2.1 Regional Programming

As mentioned in the Concentration section, the revival of regional policy and preparation for EU accession have led to substantial development of planning institutions and processes, particularly over the last three years.

This has happened at both national and regional levels. Romania's National Development Plan for 2000–2 is, for example, the country's first comprehensive strategy and includes integrated programs for certain priority zones. Poland adopted a National Strategy of Regional Development in 2000, backed up by the Act on Support to Regional Development.

Legislation in most countries has also required preparation of regional development plans. All Lithuanian counties and Czech, Hungarian and Polish regions have been obliged by law to do so. Latvian municipalities voluntarily created five Planning Regions to carry out regional planning on the level of macro regions (NUTS III). Legislation in Latvia also requires preparation of development plans and spatial plans at both local government level and regional level (presently 26 districts and seven Republican cities are the official regional level in Latvia); regional planning on the level of macro-regions came as the initiative of local and district governments and afterwards were elaborated into the new Law on Regional Development)

Conceptually these regional plans were to be the basis of regional operating programs (ROPs), which would attract a combination of EU, national and regional/local investment funding. Realization of this aim has been distorted and confused, however, by changes in EU requirements and their mismatch with national systems of governance.

The main problem has been the EU stipulation that ROPs should cover NUTS II regions that should have a minimum population of one million. Only in Poland does the regional level of self-government (*wojewodztwa*) conform to this size. Elsewhere the pre-existing counties (Hungary, Lithuania, Romania) and newly created regions in the Czech Republic have been closer to a half million in average population. To meet the NUTS II requirement 19 Hungarian counties have had to be combined in seven development regions, fourteen Czech regions in eight, 41 Romanian counties in eight. Except in Poland ROPs have accordingly been framed by regional development councils or "monitoring committees" which are not directly elected bodies but nominated representatives of constituent self-governments, state agencies, employers, trades unions, etc.

Nor do these planning regions necessarily reflect some geographic identity or single socio-economic character. A major consideration in the wealthier countries such as Hungary has been eligibility for Objective I funding, potentially available from EU structural funds for NUTS II regions whose per capita GDP is less than 75% of the EU average. Boundaries have been drawn to ensure that no city or county above this level disqualifies the whole region, leading to somewhat artificial combinations of richer and poorer neighbors; such marriages of convenience are not celebrated for compatibility and harmony.

In the Baltic States the progress made in developing regional programs was effectively halted when the EU opted for single NUTS II region and ROPs, since it was generally assumed that they would have no impact on actual allocations.

2.2 Impacts on Investment

How much impact regional programming will have on investment funding in the future is unclear (except perhaps in Poland). It depends, firstly, on the balance to be struck between EU funding of regional and sectoral programs. This depends significantly on national choice since the EU insists that structural funding is only supplementary to national investment. Currently the bulk of pre-accession funding is devoted to ISPA and SAPARD, which are essentially sectoral in nature and micro-regional in application.

Secondly, in the smaller countries such as Slovakia and the Baltic States, the EU has abandoned the ambition to fund regional development on a sub-national basis. Whole countries are to be treated as both NUTS I and NUTS II regions and regional development programs rolled into single national ROPs. The political and administrative difficulties of forming sub-national NUTS II regions and fear of bureaucratic overload at Brussels have both contributed to this retreat.

Nevertheless, regional programming is having an increasing impact on public investment in a number of ways. The first and most obvious effect is where comprehensive regional programs have been undertaken as in the pilot PHARE programs in two Czech regions and three Hungarian counties. The eleven Industrial Restructuring Zones selected for priority in the Romanian 2002–5 NDP are due to receive funding for a mix of environmental, infrastructural and human resource investments. The Romanian report refers to extensive consultation with regional development councils in compiling the NDP, a significant departure from previous practice.

Secondly, the recent second wave of devolution to regional or local self-governments in the Czech Republic and Poland (plus greater fiscal decentralization in Romania) has brought some additional objects of public investment within the scope of local choice and preference. In Poland, for example, this has involved the devolution of responsibility for secondary education, medical care, regional roads, business support and human resource development funds.

Thirdly, the formulation of regional strategies and the institutions engaged in this process (regional governments, regional development councils and agencies, etc.) should enhance local capacity to bid for allocations under sectoral programs. How far this results in reducing disparities does depend, however, on the equalization of regional/local fiscal capacity for co-financing, a point to which the following two sections will return.

How far sectoral programs are influenced by regional strategy varies between countries. In both the Czech Republic and Hungary allocations of funds for business, human resource and rural development have been increasingly "regionalized" in terms of geographical distribution. In Latvia, on the contrary, sectoral programming ignores the obligation to include a regional dimension, reflecting an implicit overall drive for growth. "The National Development Plan talks of balanced development but contains no targets or action plans to achieve it." In Lithuania county regional development plans are not considered when the State Investment Program is drawn up, and they only influence the bids made by county governors for sectoral funding pertaining to their very limited competences.

A potentially important reconciliation between regional and sectoral approaches to investment is attempted by the planning contracts between the Polish state and its regional governments. Modeled on French practice, these are multi-year agreements covering investments within a region whether funded by state, regional or local government programs. Lump sum allocations are made by the state budget governed by a formula, allocating 80% by population and 20% inverse to levels of GDP per capita and employment (10% each). Use of these funds is proposed by the regional government and agreed with national government in the person of the minister responsible for regional development. The laws define eligible sectors very broadly and impose a percentage breakdown between them (e.g., 12% for human resource development). Counties, municipalities and other agencies are partners to the contracts in respect of projects within their competence and contribute matching funds. Though the various agencies execute their own component projects, the contract does give participants opportunity to influence each other's project choices, locations, etc., improves consistency between investments and provides some medium-term perspective to the investment program. In fact, an early change of government and fiscal climate forced renegotiation of the contracts, but the framework remains in place.

Finally, the Lithuanian report introduces an underlying skepticism about the recent emphasis on programming. "The fact that most advanced countries do not have national development planning or acquired it only recently, as well as the fact that in many such countries regional development policy appeared only recently, is very telling."

3. PARTNERSHIP AND SUBSIDIARITY

How far are regional institutions, local governments and "socio-economic partners" involved in the selection, design and execution of public investment programs?

3.1 Municipal Government

In most of the countries studied the municipal tier of self-government has played a major role in investment over the last decade. In 2000 it accounted for 40% of public investment in the Czech Republic, 41% in Poland and 332 million EUR in Romania.

Most of this investment was undertaken in some form of partnership with national government, co-financing grants or accepting credit provided by the state budget, EU (mainly through ISPA, SAPARD and PHARE) and off-budget funds (mainly environmental and road funds). But, as discussed in respect of additionality, substantial cost shares have been borne by municipal revenues.

Experience in the Czech Republic is typical. Municipal participation has been high in investments in environmental infrastructure (water, sewerage, solid waste, heating), industrial parks, support to small and medium enterprises, rural "revitalization" and energy saving, but low in tourism, other forms of business support and (surprisingly) housing.

There are a number of reasons for the prominence of the municipal role. The first is the almost universal responsibility of municipalities for investment in environmental infrastructure. Major upgrading of sewage and solid waste treatment and disposal and conversion of coal-fired heating plants have been major priorities in every country. The "green" lobby generally enjoyed more license than other forms of vocal dissent in the Communist-era and was better prepared to press its case in 1989. This pressure has been substantially reinforced by EU accession requirements. They are also very costly and rank highly in overall volumes of expenditure. In countries such as Hungary and Poland substantial subsidies have been available from state budgets and environmental funds financed from penalties, and municipalities have also borrowed heavily for these purposes.

In the early 1990s municipal revenues in most countries left significant margins for capital expenditure. Only in Hungary did local government take immediate responsibility for those local services that entail large recurrent costs like payment of teachers' salaries. The surplus of revenue over operating expenditure was reinforced by sales of the substantial real estate that passed in most countries from state to municipal ownership.

The importance of the municipal role needs a number of qualifications. Firstly, the municipal capacity for financing investment is generally in decline. National budget deficits have reduced the real value of intergovernmental transfers in relation to local responsibilities, while in countries like Poland and Romania social services like education with heavy current costs have been progressively devolved on local self-government. Repayment of credit is now a burden on many municipalities, in some cases crippling. In some cases access to fresh loan finance is constrained by statutory debt ceilings.

Secondly, this financial capacity varies considerably between municipalities, depending on their size and prosperity and the adequacy of equalizing mechanisms. The Romanian study comments that cities were far better placed than towns faced with a vicious circle, the high running costs of their housing, heating and public transport restricting the funds available for the replacements, repairs, insulation, etc., needed to reduce them.

Thirdly, municipal investment has contributed significantly to reducing disparities in infrastructure and environmental quality (demonstrated in the Hungarian and Polish studies), but only a small portion is directed specifically at increasing incomes and employment.

3.2 Regional and County Government

With the possible exception of Romania, regions and counties have played a far smaller part in public investment than municipalities.

Romanian counties have been significant investors because they own and control public utility companies (a situation common in the former Soviet Union, but not in

Central Europe). They also have a major role in the distribution of revenue shares and more current finance flexibility than central European counterparts.

There is an official upper tier of self-government in Latvia—these are 26 districts and seven Republican cities (NUTS IV level). Since these districts are not directly elected, the councils of districts consist of chairmen of lower level municipalities. As a gesture municipalities have voluntarily created Planning Regions on NUTS III level. Lithuanian counties have very limited competences; they are obliged to produce regional development plans but these have had little practical effect on public investment.

Hungarian counties were retained as tiers of self-government in 1990, but in a severely emasculated form. Their limited competences are largely in the social sphere, they have no taxing power and depend on transfers supplemented by highly discretionary deficit grants; county capitals are outside their jurisdiction. Their chairmen preside over county development councils comprising representatives of state agencies, municipalities and "socio-economic partners" that allocate state budget investment grants and subsidies. A similar role in allocating EU-funded programs has been given, however, to parallel development councils at the level of the seven NUTS II regions.

Czech regional governments only came into office in 2001. They have no taxing power and depend on revenue shares and grants which as yet cover no more than operating costs, leaving no margin for capital expenditure or debt service. They have responsibilities for the coordination of regional development but it is far from clear how these are going to be exercised; before they came into existence ROPs were formulated for larger NUTS II regions by "monitoring committees" with mixed state, municipal and non-governmental representation.

To some extent Poland parallels the Czech Republic. Its sixteen regional self-governments are also latecomers, created in 1998; they account for only 5% of local government expenditure, have no taxing power and depend on tax shares and equalization subsidies leaving little margin over operating costs. Nevertheless their role in the coordination of investment is more explicit and potentially important. This is enshrined in the formulation of regional development plans which are then the bases of the contracts with the government governing the use of both regional and sectoral development funds on a three-year rolling basis. Polish marshals (elected regional chief executives) have been successful in securing municipal participation in these contracts and thereby leveraging the greater volume of disposable funding at that level as counterparts to state funding.

3.3 The Non-governmental Sector

Non-governmental bodies are frequently "partners" in public investment programs as recipients/beneficiaries. Public utility companies, for example, receive loans and grants for building or renovating plants; SMEs receive loans and business advice or acquire plots on industrial estates.

Partnership in the design of development strategies and programs is far more limited, although there are examples. The conventional "socio-economic" partners—chambers of commerce, trades unions, etc.—are normally represented on the regional development councils, regional monitoring committees etc responsible for approving ROPs and often partners in creating regional development agencies. The latter have had varying roles and success but normally assist potential beneficiaries in preparing applications for investment funds. Nevertheless, the types of public/private partnerships incorporating private enterprise investment put together in EU member states to attract structural funds have yet to emerge.

4. ADDITIONALITY

How far do public investment programs require co-financing by local government and final beneficiaries?

4.1 Requirements

The country analyses show that EU-funded programs such as ISPA, SAPARD and PHARE, have strong co-financing requirements.

The practice with state budget programs is less uniform. Additionality may take the form of liability to repay loans; the Polish Environmental Protection Fund, for example, provides a mix of 30% grant and 70% subsidized credit. However, it is often possible to match one source of state assistance with another. Hungarian municipalities, for example, have been able to finance environmental infrastructure entirely with combinations of credit and grants from different national programs.

One outstanding uncertainty in most countries is the future location of responsibility for co-financing EU structural funds after accession. The probability is that this will be largely assumed by state budgets, a financial relief to sub-national government, but a reduction in its leverage over the use of the funds.

4.2 Impacts: Administrative Constraints

The previous section referred to the high volumes of municipal capital investment, most of it financed with some combination of state and municipal revenue. The Polish and Romanian studies also report the considerable extent of capital cost recovery through consumer charging by utility companies.

Additionality requirements obviously enhance resources for public investment, but they also impose substantial limitations on it. The first relates to bureaucratic constraints. In some cases single year budget cycles restrict the ability of either state or municipal governments to pledge funds to a co-financed project that will take longer to implement. Latvia has overcome this with the introduction of three-year rolling budgets, but in the absence of this many projects rely on annual partial funding agreements that often leave investments incomplete. A related constraint is the instability of intergovernmental financial relations, with local government grants and revenue shares often subject to annual formula changes.

Additionality is also increasingly constrained by statutory debt ceilings. The initial post-communist local government legislation of the early 1990s was extremely relaxed by international standards in its attitude to borrowing. National policies have changed both because of some municipal default on bond redemption (highly publicized but not in fact that widespread) and of the adoption of Maastricht Treaty restrictions on public sector indebtedness in pre-accession negotiations. Recent Polish legislation is typical in restricting annual debt service obligations to 15% of municipal revenue.

4.3 Impacts: Affordability

The biggest constraint, however, is affordability. This is as much a relative as an absolute limitation, distinguishing between the ability of different local revenue bases to match funds available from the state, EU or other external sources.

Differences in local fiscal capacity to match external funding obviously run counter to the amelioration of income disparities and the principle of concentration. They can be mitigated, either by: (i) general revenue equalization systems or (ii) variations in co-financing requirements.

The extent of revenue equalization varies between countries. Systems fall into two categories. In the first, intergovernmental transfers are "equalized" in themselves but do not attempt to even out disparities in municipal "own" revenues. Well over 50% of the overall revenue of Hungarian municipalities comes from state grants that are calculated normatively, but there are huge per capita disparities in the local and other revenues making up the balance. A similar situation exists in the Czech Republic. The largest revenue source for Czech municipalities is shares of state taxes; these shares have varied over the last decade, but from 2001 the allotted percentages of the shared tax yields are distributed strictly per capita with a weighting for population size.

In the second category are systems that seek to reduce differences in local revenue bases. A horizontal equalization system in Poland supplements municipalities with per capita revenues below 85% of the national average at the expense of those more than

150% above. Latvia has a system of horizontal equalization based on assessments of both revenue capacity and spending need. Its formula aims to bring the revenues of municipalities up to 90%, cities up to 95%, and of districts up to 100% of estimated expenditure need. A similar system operates in Lithuania. In Romania funds amounting to approximately 26% of Personal Income Tax are allocated for both vertical and horizontal equalisation, but their distribution between municipalities is at the discretion of county governments and has proved both unstable and regressive.

The other way of mitigating differences in ability to match external resources is to link the amount of co-financing to revenue capacity. This can be achieved by varying matching ratios or, in the case of loans, rates of interest. Only one example of such practice is revealed by the studies. In Poland interest on state investment loans is charged at rates between 10% and 50% of bank rate according to the type of local government and its per capita revenue.

The Romanian report particularly emphasizes the adverse impact of differing co-financing capacities on regional development and the need for compensating mechanisms.

5. TRANSPARENCY

How far are the criteria and procedures for distributing public investment funds clearly defined, publicized and executed at the stages of inviting applications, project selection and associated procurement? How adequate are the processes of *ex post* monitoring and evaluation?

The evaluations in the six country studies give a very mixed response to these questions. The highest ratings go predictably to donor funds (chiefly from the European Union and World Bank) since their uses are governed by very explicit agreements with national governments and compliance is open to severe scrutiny. Far lower scores for transparency are attached to state budget or off-budget fund capital grants to local governments, utility companies, etc. and to allocations from sectoral ministry budgets. Hungarian examples include national funding of labor force development, tourism and environmental infrastructure. There is much reference to the vagueness of rules and lack of publicity. In the Czech case much blame is attached to the multiplicity of relatively small and competing subsidy programs in fields such as SME development. Nevertheless there is a general sense that administration of non-donor resources is improving, partly under the general emphasis in pre-accession negotiation on the improvement of public accountability.

A number of reports stress that although the eligibility criteria are clear, there are no transparent procedures for comparing one eligible project with another when, as is common, applications exceed the funds available, no clear weights by which they can be ranked. It is at this stage that political preference and patronage determine, or at least influence, access to funding.

Transparent allocation of funds is not the end of the story. Capital investment depends heavily on procurement of construction services and equipment, a fertile area for corruption in all countries. The risks of design failure, contract default and cost overruns can also be notoriously high. Interestingly, the Polish study suggests that media scrutiny generally ensures adherence to transparent procurement procedures. The Hungarian report takes a different line in criticizing the procurement of consultants for project design; frequent re-tendering allows politically favored firms illicit access to rival bids and opportunity to make their own more competitive. Other reports, particularly from the Czech Republic, Poland and Romania emphasize the weakness of machinery for *ex post* monitoring and evaluation of project execution and outcomes.

6. CONCLUSIONS

6.1 Regional Government

The role of regional self-government in the promotion of regional development is still unclear and unproven, although the Polish example may offer some clue to its future.

Communist rule generally left county government with a bad image. The first wave of public administration reform after 1989 either excluded the county level from the system of self-government as in Czechoslovakia and Poland or severely restricted its resources and responsibilities as in Hungary. It retained a far stronger role in Romania but acted more as a constraint on municipal freedom than as an agent of local democracy.

As a result subsequent reform of the upper level of sub-national administration has been slow and contentious. In practice, the argument for regional self-government in the Czech Republic and Poland (as also in Slovakia) has had more to do with removing power from a thoroughly unaccountable layer of state bureaucracy than with facilitating regional development. EU pressure has helped to turn the tide in favor of the reformers, though even this has been as much concerned with fulfilling the Copenhagen criteria of accountable government as with the channeling of structural funding.

In another sense the EU search for regional development partners has confused the public administration reform. NUTS II sizes have seemed to demand larger self-governing regions than politicians were willing to create. At its crudest minimum regional populations of one million threatened to deprive too many cities of regional capital status. Only in Poland do self-governing regions enjoy NUTS II status.

Municipal governments have been longer in the development/investment game for a variety of reasons. With the possible exception of Romania it is predominantly their functional responsibilities such as environmental infrastructure that are the focus of investment and, unlike the regions and counties, they have real-estate and disposable tax incomes to contribute to development packages. Real-estate ownership, land-use planning and construction control are also pertinent municipal weapons in the attraction of inward investment.

The Polish case does, however, suggest that regional government over time can achieve a significant role in the coordination of regional development. Substantial sectoral responsibilities such as business and human resource development are now in its hands and the regional planning contracts, together with their supporting lump sum allocations of state budget funding, have given them a substantial voice in the allocation of investment finance. Poland is, of course, the largest of the countries under study with the greatest geographical reason for an intermediate level of coordination.

The Czech and Slovak regional governments could over time achieve a similar role despite their lack of NUTS II size. It will be extremely hard for any Hungarian authority to do so given the current division of power between regions with no geographical coherence or democratic legitimacy and the counties whose self-government role is so anemic.

6.2 Regional Policy

National concern about growing disparities in income and employment has strengthened in countries such as the Czech Republic and Hungary during the late 1990s. It has resulted in some comprehensive regional development programs in disadvantaged regions, mainly as PHARE pilot schemes. However, reports stress that disparities within regions are far more significant than those between regions. More common and, arguably, more relevant have been locally and sectorally targeted responses, e.g., business support, labor force development, rural revitalization, industrial restructuring aimed at towns or micro-regions affected by the collapse of localized industry or agriculture.

The reduction of disparities has never been a dominant concern, however, and it has been subject both to ideological opposition and fluctuating attention. Motorway development is an example. This has great impacts on the location of growth; transportation is of crucial importance, for example, to the production of manufacturing components, the development of new agricultural markets and the growth of service industries. Linkage to EU networks has been a far higher priority than access to deprived regions. The M3 is wending its way to Nyíregyháza very slowly and connections from Prague to Dresden and Nuremberg are constructed more urgently than to Ostrava. The Polish formula for regional development support contains a 20% weighting in favor of regions with below average income and employment, but such bias is frequently offset by the greater ability of richer localities to co-finance national funding. In any case, public investment cannot by itself counteract the advantages of wealthier regions in attracting private investment.

6.3 Regional Development Planning

Great effort has gone into creating a legislative and institutional framework for regional development planning and numerous plans and "operating programs" have emerged. The question remains what impact they will have on actual public investment, most of which still flows through nationwide sectoral channels.

What difference does it make? Many decisions critical to local development are bound to remain at national level; motorway development has already been mentioned. The components of regional and sectoral programs are virtually the same. What differs is the right of self-government at regional or local government to allocate money between them and their discretion in adjusting implementation detail like location to local priorities. The Polish regional contracts illustrate a "half-way house" with regional governments making detailed choices in agreement with national government and within a framework of sectoral priorities.

Here, we come against the issue of efficiencies of public choice. Proponents of fiscal federalism and local public choice argue that the more local the choice, the more efficient. This is oversimplistic. The Polish study argues that regional programs are unduly weighted in favor of road schemes simply because their dispersal and visibility satisfies the demands of political horse-trading within regional executives. All expenditure involves a hierarchy of choice from the allocation of x million EUR to transportation to the siting of a culvert. Who knows best varies with the level of decision.

If substantial structural funds are allocated to ROPs, regional development plans may govern equivalent volumes of public investment. If not, their main utility may lie in providing a coordinated and rational basis for bidding for and deploying funds available under nationwide sectoral programs.

In such a process regional governments have a potentially valuable role simply because of political clout. They may have few resources to contribute but a Polish Marshall or a Czech *Hejtman* is a significant political figure whose inquiries and demands cannot be easily ignored. Their ability to impose some developmental and geographical coherence on otherwise fragmented funding decisions can be important, a skill as much political as technocratic.

Ultimately, regional development is a competitive game rather than an economic science. Strategies are important, (and EU influence has obviously helped to develop them at both national and regional level), but what finally matters is the opportunistic eye for the often unanticipated and unplanned chance to give them practical substance.

PART II

Country Reports

Czech Republic

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Hungary

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Latvia

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Algirdas Petkevicius, Sarunas Radvilavicius

Poland

Mieczyslaw Bak, Przemyslaw Kulawczuk,
Anna Szczesniak

Romania

Afrodita Popa, Victor Giosan,
Victoria Goldenberg Vaida

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Investing in Regional Development:

Policies and Practices in the Czech Republic

Jiří Blažek

Jan Přikryl

Tomáš Nejdl

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1. Introduction

The Czech Republic does not currently enjoy a good international reputation either in the sphere of regional development and regional policy or for its efforts to decentralize the public sector[1]. Attempts to design new mechanisms and principles of regional policy and to decentralize the provision of public services to the regions have been cumbersome with many missteps. In short, the overall progress has been rather slow.

Nevertheless, almost ten years after the collapse of Communism, the need to change the centralized and predominantly sectorial approach towards solving problems and providing public services has emerged as a pressing issue. Although there have been considerable efforts since 1996 to speed up reform in regional policy and regional decentralization, with some important achievements, important tasks are still ahead. Therefore, the Czech experience, though full of controversies, can provide several lessons.

2. Key Problems of Local Development

2.1 HORIZONTAL FRAGMENTATION OF LOCAL GOVERNMENT

Development on the local level has been affected by several features specific to the Czech Republic. Prominent among these is a very fragmented settlement system. The Communist regime responded to the huge horizontal fragmentation of the settlement system and of local government with a rigid policy of forced amalgamation of municipalities. Though seemingly similar policies of amalgamation of municipalities were implemented also in the majority of western European countries, there were important differences. While in the western countries there were hardly any losses for merged municipalities stemming from their amalgamation - since both the provision of high quality public services and their further development were guaranteed - the situation under Communism was markedly different. Under the Communist system of central planning, the amalgamation endangered the very existence of the small villages, for it was almost impossible to obtain any resources (administered centrally) for investment or other projects in small, amalgamated villages. Even the construction of family houses was discouraged by the state measures in these villages. Consequently, under Communism, the process of amalgamation was extremely unpopular; municipalities concerned tried to delay the whole process as much as possible.

Therefore, rather paradoxically, the less rigorously enforced policy of amalgamation in western countries was much more successful (though also resisted in some cases). In countries such as Norway or the Netherlands, amalgamation resulted in a reduction in the number of municipalities into the hundreds. In the Czech Republic, the number of municipalities decreased form 11,000 in 1948 only to 4,100 in 1989. In addition, for the reasons described above, when democracy was reintroduced on the local level after 1989, many amalgamated municipalities decided, on the basis of local referenda, to split-up again and to re-establish the local government in their villages. This movement, mirroring the revival of local communities, was quite overwhelming, as more than 2,000 municipalities were re-established within the first 2-3 years of transition, thus increasing the number of municipalities by about 50 percent to approximately 6,200. The number of municipalities now appears to have stabilized (see Table 1).

[1] The work on the manuscript has been completed on June 30, 2002.

The 1990 decision to abolish the regional level of administration (consisting of eight regions) also had important implications for local development. This measure was taken mostly for political reasons, especially to destroy the Communist hierarchical system. At the same time, it was decided to leave only the functions of the state administration at the district level. Consequently, a significant re-allocation of responsibilities had to take place. Some responsibilities (especially from the regions) were transferred to the bodies of central administration while some others were assigned to the districts or even to municipalities.

Table 1. Territorial Structure of Public Administration in the Czech Republic

Year	Number of municipalities	Number of districts	Number of regions
1989	4,231	76[2]	8
1999	6,234	77	0
2001	6,258	77	14[3]

Sources: Czech Statistical Office, The Constitution of the Czech Republic.

The huge territorial fragmentation of local government and the abolishment of regions, both have many important implications for the relations between the state administration and the local government, as well as for the design of the system of local government financing. The large number of small municipalities has caused two principal problems since the beginning of the transition. The first problem was the huge gap between the acute investment needs of small re-born municipalities. This problem was caused by the sharply restricted possibilities for investment under Communism on the one hand, and the very limited size of their budgets on the other. While larger municipalities could invest at least in some high-priority areas, the budgets of small municipalities usually are so limited that implementation of investment projects was rather difficult.

The second problem is connected with limited human resources of small municipalities for running local affairs. (For details on the processes of forming of local representative bodies, see Illner, 1996). The shortage of capable personnel was exacerbated by swiftly changing ("fluid") legislation during the period of transition. Many small villages do not even have the personnel to read the new pieces of legislation, let alone implement them properly. This situation significantly limits the capability of many small municipalities to take on additional competencies. To solve some of these problems, a network of about 380 larger municipalities have been formed. These municipalities were delegated some additional tasks, which they are performing also for other smaller municipalities. Although horizontal fragmentation is causing many day-to-day problems, there is also a positive side of the coin, namely the enhanced interest of citizens in the local affairs of their villages.

2.2 REFORM OF PUBLIC ADMINISTRATION ON THE REGIONAL LEVEL

The reform of public administration at the regional level has proved to be the most difficult of all the levels of public administration (Perlín, 1996; Illner, 1999, for analysis of similar problems in Poland see Czyž, 1998; in Hungary, see Horváth, 1997). Reform of the central government was necessary to allow the transition itself. Reform on the local level was vital to revive the local communities and local initiative. In contrast, reform on the regional level was less straightforward and less rational. The reform started in 1990 by abolishing eight regions and leaving on the district

[2] Until 1990, on the district level functioned bodies „elected" under communism. These representative bodies were abolished in autumn 1990. Since then, the districts are performing only the tasks of state administration. These bodies of state administration are called „district offices".

[3] Establishing of 14 regions has been approved by a constitutional law in 1997. The regions started to function in January 2001.

level only the state administration. The rationale was to cut the mutual ties of the former nomenclature cadres and to decrease bureaucracy.

However, the absence of any self-government bodies between the municipal and the state level caused many practical problems, such as the lack of an institution responsible for managing services and dealing with issues on above the municipal level. Moreover, the central ministries faced difficulties in executing their competence and therefore set up a network of regional branches (so called *de-concentrated offices*). The establishment of these regional branches was uncoordinated. Consequently, nearly all ministries designed their own network of regional branches.

There were serious objections to the creation of any new regional authorities. The most important of these were:

- Fear of increased bureaucracy and of making public administration more distant from citizens;
- Political calculations, namely, concerns that the political orientation of the representatives in some regions might differ from the orientation of the ruling party and thus hinder the transition itself;
- Fear of forming a new dualism between the two historical lands (Bohemia and Moravia) that made up the Czech Republic after the dissolution of former Czechoslovakia.

In addition, neither citizens nor politicians perceived the issue of regional administration as a priority. The situation changed after the 1996 elections when the center-right coalition lost its majority in Parliament and had to change its policies, making some concessions in order to retain its power as a minority government. Because of the changed political situation, in 1997 Parliament approved a constitutional law stating that from the year 2000 the Czech Republic will consist of 14 self-governing regions. However, the preparation of the whole package of more specific acts defining, for example, the competence and financing of new regions has been delayed. Therefore, the creation of regions was postponed by one year to January 2001. This delay caused many problems, especially in coordinating regional development measures and initiatives.

2.3 RE-ESTABLISHING OF THE FISCAL AUTONOMY OF LOCAL AND OF REGIONAL GOVERNMENT

Solving the Dilemma between the Principles of Solidarity and Meritocracy

Two important components of the re-establishment of the democratic system on the local level were restitution of municipal property (the vast majority of which had been owned by the state) and re-establishment of local financial autonomy. The problem of municipal financial autonomy proved to be especially difficult to solve. The design of the new financial system of Czech local governments can be described as a *trial and error* approach. At least four different systems can be identified in the period from 1990 to the present (see also Blažek, 1996b).

The first period was 1990-1992. Because of general mistrust of the central redistribution of resources under Communism, there was strong pressure from newly elected local representatives to decentralize part of the tax system. However, in the first years of the transition a radical transfer of competencies was carried out. The transfer of competence had to be paralleled by a transfer of financial resources for local authorities to perform these tasks. This was often done in the form of general or special grants. Therefore, until 1992, the main financial resources (about 70 percent of the total) of local government were received in the form of grants.

In 1993, a radical reform of local government financing was executed to increase the percentage of revenues that local government generated from their own jurisdictions. The core of the reform was that revenues from personal income tax were allocated to local government. At the same time, the grants were cut correspondingly. The system was rather complex (see Table 2), with a strong equalization mechanism operating among the municipalities within the districts on a per capita principle. On the other hand, among the districts, there was rather modest equalization mechanism represented by relatively small *territorial equalization grant* (amounting only to about 2 percent of local budgets). This second period lasted to 1995.

The third period started with the reform of 1996 and lasted until 2000. The rationale for the 1996 reform was threefold. Firstly, the revenues allocated to local government were growing more swiftly than the revenues allocated to the state budget. Consequently, the share of the state in the public budget has been shrinking. This was considered improper since state government responsibilities were not decreasing. Secondly, there were considerable disparities among the districts (and their municipalities) in per capita tax revenues according to the strengths of local economies. The disparities were seen as contrary to the interest of the state in guaranteeing the provision of a comparable level of public services throughout the state. In addition, the disparities were considered unjust because the local authorities had no power to set the rate of taxes and therefore, municipalities could influence their tax revenues only marginally. Thirdly, the government intended to stimulate the municipalities to promote more actively the economic activities on their territories.

The main element of 1996 reform was the replacement of 40 percent of revenues from swiftly growing personal income tax with 20 percent of stagnating revenues from business tax. At the same time, the allocation criteria among the municipalities were changed (see table 2).

Table 2. Main Reforms of Local Government Financing System

System between 1993-1995	System between 1996-2000	System 2001
100 % of revenues from personal income tax paid by employees working in the particular district, of which 45 % allocated to particular District office and 55 % distributed among municipalities within particular district according to per capita principle	60 % of revenues from personal income tax paid by employees working in the particular district, of which 30 % allocated to particular District office, 20 % distributed among municipalities within particular district according to per capita principle and 10 % allocated to municipality according to working place of employees	20.52% share on national revenues of VAT, on business tax, on personal income tax paid by employees and on personal income tax paid by small entrepreneurs[4]
100 % of revenues from personal income tax paid by small entrepreneurs allocated to municipality according to permanent living place of the entrepreneur	100 % of revenues from personal income tax paid by small entrepreneurs allocated to municipality according to permanent living place of the entrepreneur	30% of revenues from personal income tax paid by small entrepreneurs living on municipal territory
	20 % of revenues from business tax, allocated to all Czech municipalities equally according to per capita principle	Transformed into shred taxes (see above)
100 % of property tax	100 % of property tax	100 % of property tax
other income: local fees, loans, etc.	other income: local fees, loans, etc.	other income: local fees, loans, etc.
territorial equalization grant (general grant)	territorial equalization grant (general grant)	Abolished
special grants	special grants	special grants

Source: Acts on state budget of the Czech Republic in 1995, 1996, 2000

[4] Firstly, however, a 30% share of revenues is allocated to the municipality where the entrepreneur is having permanent address.

The impact of the system introduced in 1996 has been multi-faceted. The most important change was the weakening of the strong equalization mechanism operating among municipalities within the particular districts and the introduction of a relatively strong equalization mechanism at the inter-district level. Therefore, since 1996, there have been equalization mechanisms both within and between the districts. The biggest losers were the large cities especially, such as Prague or Ostrava, which lost 40 percent of their buoyant revenues from personal income tax. This loss was compensated only by the average per capita share of business tax. Surprisingly, the second group of losers consisted of the smallest municipalities, which usually have only limited employment opportunities and therefore do not receive the 10 percent share of personal income tax allocated to the municipality according to working place of employees (see Table 2). On the other hand, the 1996 system significantly helped the local authorities in the districts with weaker economies. Nevertheless, sizeable disparities in per capita revenues remained among the districts. The central government therefore proposed yet another financial system for local government.

The 2001 Reform of Local Government Financing

The reform entered into effect in January 2001 and originally should have allowed for financing of the fourteen new regions that were introduced in the same time. (However, due to poorly prepared regional reform of public administration, this proved to be unrealistic and regions in 2001 were financed mostly by special grants). The substance of the new reform is an equal sharing of both parts of the personal income tax (paid by employees and by small entrepreneurs) and of part of the business tax and value added tax equally by all municipalities on a per capita basis (see Table 2). In addition, the municipalities were arranged into several categories according to their population size. Each category was assigned a coefficient reflecting the fact that larger municipalities and cities are performing functions for outlying areas. The new system is clearly over-stressing the solidarity principle over the principle of meritocracy and results in an extensive redistribution of sources while providing little incentives for local initiative.

Since the beginning of the transition, the development of the system of financing for Czech local governments has been far from straightforward. The main reason for the frequent changes in the system is the lack of a broad agreement between the central government and representatives of local government on the basic principles of the system’s design. The latest proposal shows that the rule is not yet stable and not likely to be in the near future. The considerable instability of the system of local government financing can be counted as one of its principle shortcomings.

Capital Expenditures of Local Government

Municipalities are much more important investors than would follow from their share of the HDP or public expenditures. While the local government share of the GDP permanently oscillates between eight and ten percent (see Table 3), their share of total investment has never been lower than fifteen percent since 1993.

Table 3. The Share of Public Budgets on GDP (In %)

Public budgets	1993	1994	1995	1996	1997	1998	1999	2000	2001
State budget	34.49	33.08	30.96	29.86	30.21	30.31	31.48	35.81	33.83
Local budget	8.94	9.67	9.54	10.80	9.02	8.78	9.42	9.79	8.33
Total	43.43	42.75	40.50	40.66	39.23	39.09	40.90	45.60	42.16

Source: Ministry of Finance of the Czech Republic

The role of municipalities in investment activity within the public sector alone is even more important. Although the local government share of public budgets has been decreasing since 1996, their share of investments from the public sector is slightly growing (see Table 4). The share of financial resources allocated to investment in municipal budgets is twice or even three times higher than that of the state budget (see Table 5). The share of investments in local budgets fluctuates around thirty percent while in the case of the state budgets the share is just ten to fifteen percent. Consequently, investments made by municipalities represent about forty percent of public investments in the Czech Republic.

Table 4. The Share of Local Government on Public Budgets (In %)

Public budgets	1993	1994	1995	1996	1997	1998	1999	2000	2001
State budget	79.41	77.39	76.44	73.45	77.01	77.52	76.96	78.53	80.25
Local budgets	20.59	22.61	23.56	26.55	22.99	22.48	23.04	21.47	19.75
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Ministry of Finance of the Czech Republic

Table 5. The Share of Capital Investment on Local Government Total Spending (In %)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Share	28.46	29.64	31.26	25.72	28.91	27.06	26.38	33.15	29.14

Source: Ministry of Finance of the Czech Republic

The principal reason for such an important position of local government capital investment within the public sector is the way the competencies were assigned among different levels of the public sector. Local governments are responsible for capital-intensive areas like water systems, sewage and sewage systems, local roads, school buildings, etc. At the same time, municipalities are fighting with huge internal debt accumulated in these areas under the communism. Moreover, local representatives are exposed to considerable pressure from local people, especially from local businesses, to solve fundamental problems hindering local development and improvement of standard of living in general.

Both these pressures (i.e., delegation of costly responsibilities from the central government and pressure from local subjects) result in a situation where municipalities allocate to capital expenditures permanently approximately twice again the financial resources than represented by their capital revenues. (On average, from 1997 to 2000, the capital revenues represented only fourteen percent of total revenues of local governments).

However, there is also a negative side of this theoretically positive trend. This dependency of municipal investment activities on state financial assistance is high. According to a survey performed by the Ministry of Finance in 1997, state grants covered 25.5 percent of municipal capital expenditures and state interest free loans another 5.1 percent. It can be expected, that this situation, where state transfers cover one-third of municipal expenditures, continues to the present. It is clear that a large proportion of these investments would not be implemented without such state support. Due to the considerable instability of state support policy, (which is guided by annual state budgets) municipalities are forced to adjust their investment priorities according to the focus of state support programs. This situation, in fact, boosts investment activity as municipalities are forced to use the opportunity even if this opportunity is not considered as such by local representatives. At the same time, this phenomenon contributes to increase of municipal debt. Finally, another weakness of such model is that it contributes to creation of the mentality of municipal dependency on the state and to the temptation to solve infrastructural deficit by cheap (subsidized) grants instead of expensive (non-subsidized) maintenance and repairs.

The survey also shows that commercial loans covered seventeen percent of capital expenditures made by municipalities. Consequently, from public resources, municipalities covered only 52.4 percent of their capital investments. These average figures would inevitably differ according to population, size category of municipalities and other factors. However, it can be generally concluded, that the smaller the municipality is, the smaller part of its budget is devoted to capital expenditures. Thus, concurrently, it is more dependent on transfers from state budget and state funds.

Financing of Self-Governing Regions

In April 2000, the Parliament passed Act 128/2000, which enacted establishment of fourteen self-governing regions. By this step, a decade of intensive political and expert discussion on relevance of the regional level of public administration, about its functions, territorial delineation, elections and representative bodies was completed. Unfortunately, within this discussion only marginal attention has been devoted to the problem of design of adequate system of financing of regions.

An attempt to endow the new regions with their own stable income base, over which the elected regional bodies could exert their discretion, failed. This was partly due to the objective reasons that the competencies in the sphere of the public sector provision, but also in the sphere of regional policy, have been transferred to the regions only within the course of the year 2001. Therefore, it was difficult to specify exactly the volume of needed financial resources. In consequence, both for year 2001 and for the year 2002, the financing of the regions is proceeding only according to the temporary model in the form of the Act on Budgetary Allocation of Tax Revenues, which is and will be adjusted annually. According to this act for 2001, no own revenues were assigned to the regions. Consequently, the regions have been fully dependent on state specific grants.

As far as 2002 is concerned, the regions were allocated 2.52 percent of personal income tax (with the exception of personal income tax paid by small entrepreneurs) and the revenues of individual regions are corresponding to their population. The regions were also given 10percent of revenues from personal income tax paid by small entrepreneurs on their territory but special coefficients were applied to mitigate differences between *rich* and *poor* regions. Despite these changes, the regions will remain from at least 80 percent dependent on state specific grants even in the year 2002. Very low volume of public revenues hinders not only any more significant public active support policy but also limits their possibilities to participate in state support programs that require co-financing by final beneficiaries. Moreover, a systemic weakness of the existing system of financing is excessive stress on equalization.

3. Development of Regional Disparities and of Regional Policy under Transition

3. 1 DEVELOPMENT OF INTER-REGIONAL DISPARITIES IN THE CZECH REPUBLIC UNDER THE TRANSITION

The Czech Republic entered the transformation period as a country with relatively minor inter-regional disparities. This was the result of strong equalization policy pursued under communism. The equalization policy was quite effective but very inefficient and lead to more and more overt lagging behind the west European countries in the sphere of societal development.

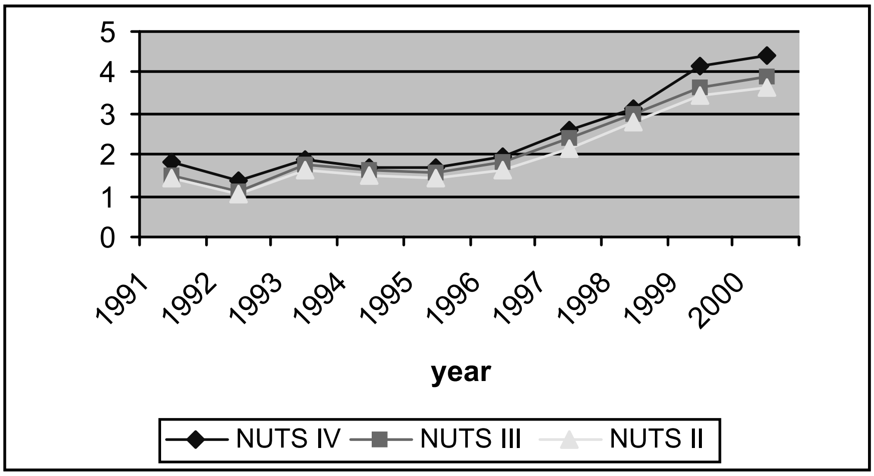
The general tendency of regional development in post-Communist countries after the collapse of Communism can be described as *differentiation* (Blažek, 1997a). Therefore, relatively modest interregional disparities inherited by the Czech Republic from the Communist period (Fuchs and Demko, 1979, for wider context see Enyedi, 1990, Barta et al.1997 and Hajdu et al. 1994) have been swiftly amplified. Generally, diversified metropolitan regions have performed better than non-metropolitan, old industrial and rural regions (Hampl, 1999). The inter-regional disparities developed due to operation of the whole complex of interconnected factors such as vertical and horizontal geographic position, economic structure, industrial and entrepreneurial tradition, geographic position, educational structure, development of technical infrastructure and the state of environment (Blažek, 1999, Hampl 1999).

Regional disparities have started to deepen profoundly especially since the mid 1990s. The rate of economic growth plummeted and even reached negative values. The rate of unemployment more than doubled between December 1995 and December 1998 and in several districts reached levels calling for serious concern (even more than 20 percent during year 2000).

In the EU, the regional disparities are measured on the level of the NUTS II and NUTS III regions. These regions are used as a comparative basis in the sphere of policy of economic and social cohesion and for statistical purposes. In the Czech Republic, eight NUTS II regions and fourteen NUTS III regions were defined in 1999. The Czech districts (77) are considered NUTS IV regions. In respect to the fact, that the Czech Republic (with the likely exception of Prague) will be considered an Objective 1 region after the accession, the most important level seems to be NUTS II used for definition of this category of assisted regions. While the criterion for eligibility for support according to Objective 1 is the level of per capita GDP in PPS over the last three years (should be less than 75 percent of the EU average), the size of inter-regional disparities is most frequently measured on the basis of unemployment. More specifically, the size of inter-regional disparities in the unemployment rate is most often measured by EUROSTAT as the weighted standard deviation (WSD). The standard deviation is weighted by the size of the NUTS II regions, which is measured either by the number of economically active population or by number of inhabitants.

Official delineation of NUTS regions in the Czech Republic allowed calculating the development of inter-regional disparities on the basis of these relatively comparable regions. The calculation is based on the rate of unemployment in December of respective years and the number of inhabitants expressed the size of the regions. Figure 1 depicts the development of weighted standard deviation on the level of NUTS II regions, NUTS III and NUTS IV regions in years 1991-2000.

Figure 1. Development of Inter-Regional Disparities in the Czech Regions NUTS II-IV Measured by Weighted Standard Deviation.



Source: updated from Blažek, Severa (1999)

After some fluctuations in the first half of the 1990s, the curves illustrate a steep increase of inter-regional disparities since 1995. The scale of disparities depends obviously on the number of units (regions) used in analysis. Therefore, not surprisingly, the smallest disparities were found on the level of NUTS II regions (8 units) while the largest ones on the level of districts (77 units). However, given the large variance in the number of units on particular NUTS levels, the differences in disparities are surprisingly small.

Table 6. Inter-Regional Disparities in the Rate of Unemployment According to NUTS II Regions in the EU Countries (Year 1999) and in the Czech Republic (Year 2000).

Country	Rate of unemployment (%)	Weighted standard deviation	Coefficient of variation (%)	Number of NUTS II regions
Austria	4.0	1.1	27.5	9
Belgium	8.8	4.3	48.9	11
Finland	11.5	3.2	27.8	6
France[5]	11.4	2.5	21.9	22
G. Britain	6.1	2.6	42.6	35
Germany	8.9	4.3	48.3	38
Greece	11.7	2.0	17.1	13
Italy	11.7	7.9	67.5	20
Netherlands	3.3	0.8	24.2	12
Portugal	4.7	1.4	29.8	7
Spain	16.1	5.7	35.4	18
Sweden	7.6	1.6	21.0	8
Czech Republic	8.8	3.7	41.4	8

Source: The data on the EU countries were published in the 2nd Report on the Economic and Social Cohesion, Volume 2, Statistical Annex, European Commission, Brussels, 2001; rate of unemployment for the Czech Republic - The Ministry of Labor, own calculation of measures of variation for the Czech Republic.
Note: Ireland, Denmark, and Luxembourg are not shown in the table as their territory consists of small number of NUTS II regions.

Despite the fact that the Czech Republic ranks in comparison with many EU countries rather among smaller ones, it cannot be sustained that the inter-regional disparities within the Czech Republic are negligible. On the contrary, according to disparities in the rate of unemployment on NUTS II level, the Czech Republic would rank on the fifth place according to the standard deviation and on the fourth place according to the coefficient of variation. From the EU countries of relatively comparable size, only Belgium has more profound regional disparities than the Czech Republic. On the other hand, the Czech Republic does not suffer from such huge regional problems like some other transforming countries (e.g., Upper Silesia region in Poland or the polarity between Budapest and mostly rural rest of the Hungary). Similarly, some of the EU countries also struggle with considerable backwardness of several of their regions. Therefore, the regional disparities in the Czech Republic are sizeable but in comparison with other countries (both the EU and the other transition countries) are not of extreme nature. Consequently, for the Czech regional policy follows, that it should not become a cornerstone of the government policies, but on the other hand, the role of regional policy should not be underestimated.

3. 2 FORMING OF REGIONAL POLICY IN THE CZECH REPUBLIC

Despite some recent progress, the Czech Republic is still lacking a comprehensive and efficient regional policy. In the first half of the 1990s, regional policy was only a very low priority and more attention gained only relatively recently.

[5] All the data relating to France exclude the French overseas territories.

Regional Policy until 1996

In the Czech Republic, the development of regional policy can be divided into three periods during the transition. The first period lasted only between 1991-1992. During this period, the aims of regional policy were quite ambitious but no new programs were implemented in the regions. More important for future development was the second period. In the second period (1992-1996), the role of regional policy was intentionally marginalized. The reasons for this *low profile* approach of the Czech government were historical and geographical (small inter-regional disparities inherited from the former Communist regime), economic (until 1996 unusually low rate of unemployment of only about three to four percent), and political (proclaimed one-sided liberalism, unwillingness to intervene and make any *exceptions* in market rules). The official regional policy was very modest and consisted only in the offer of modest support to small and medium size firms (in the form of soft loans) in assisted regions selected in principle on the basis of the unemployment rate (e.g., more than five percent in 1996).

Nevertheless, the Czech government gradually developed a whole array of different policies with (intended or unintended) significant regional impact. But these policies do not comprise a comprehensive approach to regional issues. Almost every ministry prepared some program with important regional impact (Blažek, 1997b). For example, at the beginning of the 90s the government pursued (though not very frequently) the policy of *selective financial re-structuralization* (i.e., writing off the debts from Communist period) of large companies whose collapse might seriously endanger the regional labor markets. There are numerous other examples:

- The Ministry of the Environment distributes the resources from the Environment fund to projects aiming at improvement of environment in most polluted regions;
- The Ministry of Transport supports public transport in rural areas;
- The Ministry of Agriculture supports farmers in less favorable conditions or in environmentally protected areas;
- The Ministry of Labor allocates funds on active employment policy to district job centers according to unemployment rate;
- The Ministry of Trade and Industry supports in addition to small and medium size firms also foreign investors through regional partners of its inward agency CzechInvest (for more details see section 4.2).

The main weakness of this approach lies in its institutional fragmentation and lack of horizontal coordination at the governmental level. This problem had been until 2000 multiplied by missing regional self-government, which should play an important co-ordination role.

The Third (Current) Period of Czech Regional Policy

There were two main stimuli for development of a more integrated approach toward regional policy in the mid-90s. Firstly, the internal conditions have changed significantly, especially the growth of unemployment and the sharpening of regional disparities, but also a significant retreat of neo-liberal doctrine from Czech political scene. Secondly, an important stimulus comes from the pressure exerted by the EU, for which the economic and social cohesion is a high priority (consuming about a third of the EU budget). Moreover, the EU also undermines the provision of the support via pre-accession programs by effort of CCs in several spheres including an increase of efficiency of the public sector and design of a modern regional policy. Finally, the EU also closely observes the overall developments in CCs and the findings are annually published in Regular Reports. All these facts contributed to the fact that the Czech government has recently taken several important measures in the sphere of regional policy.

In the institutional sphere, the Ministry for Regional Development and Center for Regional Development (CRD) were established in 1996 to promote regional development. Originally, the intention was to shift implementation of the most important sectorial programs with important regional dimension into this ministry, but this has happened only in one case when the Program of Revitalization of Countryside was transferred from the Ministry of Agriculture. In the legislative area, the Regional Development Act was passed by the Parliament in 2000 (No. 248/2000). The act defines the responsibilities not only in the sphere of Czech regional policy but also in preparation and future implementation of the EU cohesion policy. In the sphere of programming, in the year 2000, the Government for the first time approved the Strategy of Regional Development in the Czech Republic. This should guarantee more efficient design of Czech Regional policy. In the sphere of support programs, in addition to the regional support to SMEs, state regional support programs were approved by the government for two most affected regions (NUTS II Northwest and Ostravsko). These programs provide support to municipalities in the regions in question in several spheres, but mainly in the sphere of infrastructure including business infrastructure like industrial zones. Consequently, also the financial volume allocated on regional policy has increased significantly.

For overview of regional support programs administered by the Ministry for Regional Development, see Table 7.

Table 7. Support Programs of the Czech Regional Policy

Program	Beneficiaries	Eligible projects	Incentives	Financial volume in 2001
Regional program for development of Northwest Bohemia and Ostrava regions	Municipalities	1. Preparation of industrial plots and buildings for business activities and revitalization of unused industrial spaces 2. Construction of tourism related infrastructure	Investment grants up to 70% of eligible costs	EUR 4.43 million
Program "RegioGuarantee" (Provision of guaranties for SMEs in Northwest Bohemia and Ostrava regions)	SMEs up to 250 employees	Wide range of projects aiming at new job creation	Bank guarantee for a loan up to EUR 0.57 million and up to 75% of total loan	EUR 0.71 million
Program "Region 2" (Provision of guaranties for SMEs in Northwest Bohemia and Ostrava regions)	SMEs up to 250 employees	Wide range of projects aiming at new job creation	Soft loans - 9% interest rate subsidy	EUR 1.14 million
Regional support program for industrial enterprises in Northwest Bohemia and Ostrava regions	Firms	Wide range of projects aiming at new job creation or increase of competitiveness	Investment grants up to 50% of eligible costs, max. EUR 0.57 million	EUR 13.49 million
Regional support program for revitalization of the former military training fields Mladá and Ralsko	Municipality	Construction or reconstruction of municipal technical infrastructure	investment grants up to 75% of eligible costs	EUR 0.51 million
Regional support program for economically weak and structurally affected regions	Municipality	1. Preparation of industrial plots and buildings for business activities and revitalization of unused industrial spaces 2. construction of tourism related infrastructure	investment grants up to 70% of eligible costs in National Parks and max. 50% in other areas	EUR 1.29 million
Program of revitalization of countryside	Municipality or association of municipalities	1. Reconstruction of municipal or other public buildings (schools, health centers, churches, etc.). 2. Upgrading of public spaces and greenery 3. Reconstruction of local roads, public lights, cycle path etc. 4. Wide range of other activities (development of master plans, education and consultancy in regional development). 5. Integrated programs (projects aiming at synergy among infrastructure, labor market policy, SMEs development, environmental care)	investment grants up to 60% of eligible costs	EUR 9.14 million
"Pilot regional operational program"[6] for Northwest Bohemia and Moravskoslezský region	Firms, subjects from public sector, NGOs	1. Investment into productive sector 2. Human resource development 3. Business related infrastructure	grants up to 75% of eligible costs, max. EUR 600 thousand.	EUR 16 million (8 PHARE + 8 state budget)

[6] This program is designed to simulate Structural Funds support. Therefore, the range of beneficiaries and of eligible activities is wider than in Czech support programs.

Source: Elaborated according to Principles of support programs, Ministry for Regional Development, 2001
Note: 1 EUR= approx. 35 CZK in December 2000

Significant effort is also devoted to preparation for the EU cohesion policy and to implementation of the pre-accession programs. In order to prepare for implementation of pre-accession support from the EU, completely new institutional structures were formed. The most important of them is the National Management and Coordinating Committee chaired by the Ministry for Regional Development and charged with overall coordination of the pre-accession structural aid.

Preparation for the EU policy of economic and social cohesion (ESC) is hampered by the lack of several key elements: missing legal codification of relations between different regional levels (NUTS III, NUTS II and the central level), not completed system of financial management and control, and non-existent suitable system for co-financing of the EU programs. Another problem is the lack of qualified people able to prepare and implement projects according to demanding EU regulations. This fact is being clearly demonstrated during the implementation of current PHARE programs. The low ability of the Czech regions to generate high-quality projects might seriously limit the capacity of the Czech Republic to receive support from EU programs in the future. A comparison of the main differences between the Czech and the EU regional policy provides table 8.

Table 8. The Main Differences between the Czech Regional Policy and the EU Cohesion Policy

Sphere	Czech regional policy	EU cohesion policy	Remark
Programming	CR until recently without programming documents, now „over-programming“ (2 sets of programming documents – one for Czech RP the other for EU cohesion policy), standard programs, low invention, top-down motivation for drafting programming documents; however, recently some progress	Already the third generation of programming documents	Excessive emphasis on analytical part, weak strategic part, no consideration of alternatives
Implementation structure	Prevailing sectorial approach	Different systems	
Integrity of approach	Narrow conception of RP and its insufficient coordination with other policies	Integrated multi-sectorial approach	Progress recently, esp. *regionalization* of sectorial policies and implementation of more integrated state support programs for affected regions
Incentives of RP	Limited spectrum of incentives used	Wide spectrum of incentives	Regional Development Act is consistent with the EU principles
Size of projects	Small projects prevailing	Prevailing large projects	
Selection of projects	Problems with transparency	Clear separation of management, monitoring and control function.	
Evaluation of efficiency and effectiveness	Weak tradition, performed infrequently and ad hoc	Systematic attention and pressure for further enhancement	Chance posed by preparation of the monitoring system for Structural Funds (MSSF).
Partnership	Weak tradition, esp. in the case of projects on supra- municipal level	Different practice	
Involvement of private sector	Low participation of private sector in preparation for and limited awareness about cohesion policy	Strong role, often significant initiative	
Public administration	Huge instability (14 new regions, planned dissolution of districts and creation of smaller districts in 2003, large horizontal fragmentation of local government and unprecedented instability of their financing	Different systems	Serious disadvantage given large expected role of regions, towns and municipalities
Volume of financial resources	Small but increasing	Many times higher	

Source: Blažek, 2001

Probably the greatest enduring problems in Czech regional policy are those of coordination of regional development measures and programs. When an acute crisis develops in one of the regions, the assistance is usually ad hoc. Therefore, a sectorial approach to regional problems still prevails.

4. The Main Financial Resources in the Sphere of Policy of Economic and Social Cohesion: An Overview

4.1 METHODOLOGY AND DEFINITIONS

The methodology used for gathering relevant information was based on analysis of activities of key institutional subjects. Firstly, the activities performed within the responsibility of all relevant bodies of central administration and their affiliated or subordinated bodies were overviewed. Secondly, tables summarizing all relevant technical information about relevant programs or policies were developed. The tables also provide specifics on the origin of financial resources, for example state budget, off-budget funds, EU support etc. Thirdly, on the basis of gathered information, an evaluation according to principles of the EU cohesion policy has been performed. Finally, the main observations about existing programs were summarized and some implications for possible future adjustments of existing programs and policies were derived (see section V.). Unless otherwise stated, all data relate to the year 2000.

Note: Capital investment is referred to here, in accordance with current specification of the Czech Ministry of Finance, as expenditures spent on activities or goods, the usage of which will be at least 3 years and, at the same time, the expenditures shall amount to at least EUR 1,400 (in December 2000, EUR 1 = 35 CZK).

4. 2 OVERVIEW OF SUPPORT PROGRAMS

In this section, the most important data on existing support programs will be provided and their consistency with the EU principles of policy of economic and social cohesion will be evaluated. Support programs are listed according to the responsible bodies of central administration as an analysis has shown that support programs administered by one body are performed usually according to a single scheme. Therefore, firstly, an overview of support programs under the responsibility of each relevant ministry or other body of central administration will be evaluated and subsequently, an overview of technical details about each program will be provided in a tabular form.

4.2.1 MINISTRY OF INDUSTRY AND TRADE (MIT)

Nationwide Programs of the Support of Small and Medium-Size Enterprises

The nationwide (horizontal) programs of the support of small and medium-size enterprise include the following programs: Guarantee, Credit, Market, Special, Capital, Mobile Shop, Cooperation, Support of Export, Counseling, Small Loans and Design.

All the above-mentioned programs shared the same characteristics in 2000:

- They were announced through a single resolution of the Government of the Czech Republic (1352/1999);
- They had the same sponsor; i.e., the Ministry of Industry and Trade of the Czech Republic (MIT CR);

- They were all administered by the same institution; i.e., the Czechomoravian Guarantee and Development Bank (CMZRB), except for the Support of Export program - Czech Trade, Counseling and Small Loans - Business Development Agency and Design - Design Center Czech Republic; all these organizations were established by the MIT CR;
- They shared the same objective; i.e., support of entrepreneurial aims of small and medium-size enterprise.

All the programs are characterized by the same instruments of support; e.g., providing guarantee, favorable credits and reimbursement of a part of interests from commercial credits. Only exceptionally, do the programs provide a non-repayable subsidy (the Market, Special and Counseling programs may subsidize part of expenditure on technical and organizational preparation of entrepreneurial aims, the Mobile Shop and Co-operation programs may subsidize a part of entry capital expenditure). Those programs that are not administered by the CMZRB state bank (the Support of Export, Small Loans and Design programs) also offer free technical assistance.

All the nationwide programs for the support of small and medium-size enterprises belong to the **priority axis of the support of enterprise (P2).** With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: as apparent from the title of this group of support programs, their main objective is not to abate inter-regional disparities - in this respect the level of concentration is null. The given programs, however, can be combined with programs of financial regional support of small and medium-size enterprise and, thanks to this possibility; the application of nationwide programs then gains a certain regional dimension. That is why a relatively large number of support programs were targeted at the affected Ostrava region and, in contrast, the smallest number of programs at Prague.

Programming: in order to be eligible to receive support from any of the above-mentioned programs, it has not been necessary so far, to include one's entrepreneurial aim into any program document - the level of programming is therefore null.

Partnership: partners in the implementation of support allocated on the basis of the given programs are usually an entrepreneurial subject applying for support, a commercial bank providing credits, the CMZRB bank and the MIT CR. The programs thus rely on the partnership of the private and public sectors. In Small Loans and Counseling programs, there is one more partner, the EU, participating through the PHARE program.

Additionality: the conditions of participation in a program are co-funding from the side of a supported entrepreneurial subject - the principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are approved by the Government, which also sets their rules (defining applicants eligible for support, the conditions of support, the period during which the support is provided, the application process etc.) and earmarks, based on the MIT CR proposal, financial means from the state budget. The CMZRB bank is responsible for the administration of these funds. This bank also distributes and accepts applications for support. On the side of the state, the criteria and procedures of the support allocation are transparent enough. In reality, however, the equal access of applicants is complicated by two factors:

a) Applications for support are accepted only until the disposable CMZRB resources are exhausted, which bestows a campaign-like character upon the support allocation system (most of the programs are implemented in the first months of the year),
b) The support allocation presupposes that the entrepreneurial aim is accepted by a particular commercial bank, which frequently disqualifies those entrepreneurial aims that show a high degree of risk.

Nationwide programs of support for small and medium-size enterprises are among the oldest support instruments of enterprise in the Czech Republic. They have been in use since 1992. Since that time, their procedures have matured and the programs are now considered a standard part of the state economic policy. This is further supported by the relatively large amount of public financial means allocated. In 2000, the CMZRB bank had at its disposal EUR 67 million for these programs (of which, EUR 55.5 million represented a contribution from the state budget, the remaining amount represented financial means of the bank itself; i.e., installments of credits). This included programs of financial regional support, since the possibility to combine these programs does not allow for a strict division of their use in accountancy. In the same year, entrepreneurs submitted 2,937 applications out of which 2,198 were accepted. Support in the form of guarantees and favorable credits enabled projects to be implemented at a total cost of approximately 400 million EUR. A large part of this support was directed at the smallest businesses. In 2000, 47 percent of favorable guarantees and 84 percent of favorable credits were provided to enterprises with less than 25 employees. The use of support means also created 1,600 new job opportunities in 2000.

In evaluating the present system of support programs, however, we find room for criticism in the great fragmentation of programs disposing of disproportionately small funds and in the complicated procedures (especially for small and emerging entrepreneurs) in obtaining support. Additionally, there is instability in programs whose momentary conditions have always been derived from funds available from annual state budgets. This situation makes for uneven interest in some of the programs of the following groups. With the *big* programs, such as Guarantee, Credit and Market, demand regularly exceeds offers, while with the *small* (and overly detailed) programs, such as the Support of Export and Small Loans, the contrary often occurs (as is the case of 2000), that the financial means allocated for support are not distributed due to lack of interest on the side of entrepreneurs.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Záruka/ Guarantee	MIT/ CMZRB	Preferential access conditions to bank loans and leasing.	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million (under 50 employees earnings EUR 7.1 million and property EUR 5.1 million); • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 2 people.	• Financially improved guarantee for the rest of bank loan or leasing (up to 0.9 p.a from the amount of guarantee; entrepreneur pays only 0.4 % p.a.).		50.6	
Kredit/ Credit	MIT/ CMZRB	Preferential investment targeted loans.	• SMEs up to 50 employees.	• Earnings EUR 7.1 million and property EUR 5.1 million; • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME); • Increase of number of employees by min. 1 person.	• Loan for implementation of business intention (due date up to 6 years, interest rate 7%, up to amount of EUR 285 thousand).		25.1	
TRH/ Market	MIT/ CMZRB	Increase of competitiveness of SMEs on domestic and foreign markets (preparation of conditions for entry to EU common market).	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million; • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME); • Implementation and certification of system of environmental management.	• Contribution in the amount up to 7% (in case of participation in VESNICE or REGION programs 3%) of interest from bank loan (up to 4 years, up to amount of contribution EUR 143 thousand); • Grant for ISO 9000 or ISO 14000 certification and for implementation of EMAS program in the amount of 50% (up to EUR 8.6 ths. resp. EUR 5.7 thousand for EMAS).		7.1	

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Special	MIT/ CMZRB	Increased employment of people from problematic groups (complementary program).	• SME under 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million (under 50 employees earnings EUR 7.1 million and property EUR 5.1 million); • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME); • Increase of employment of people form problematic groups of inhabitants.	• Grant of EUR 115 for each newly employed person and months worked out, in total up to EUR 86 thousand.		0.84	
Kapitál/ Capital	MIT/ CMZRB	Increased usage of risk and development capital in SMEs.	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million (under 50 employees earnings EUR 7.1 million and property EUR 5.1 million); • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME).	• CMZRB bank guarantee for capital entry (up to 70% of capital entry, max. EUR 428 thousand), guarantee up to 5 years); • Grants for expenses connected with preparation of capital entry (up to 3% of the entry amount, max. EUR 7.1 thousand on one capital entry).		No interest in the program	

Pojízdná Prodejna/ Mobile Shop	MIT/ CMZRB	Improvement of business service of countryside.	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million (under 50 employees earnings EUR 7.1 million and property EUR 5.1 million); • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME); • Mainly grocery and pharmacy goods in min. 15 municipalities, min. once a week; • Expression of min. 15 municipalities that they will not charge for 5 years occupation of public area.	• Grant of 50% of expenses for purchase of mobile shop (max. EUR 43 thousand).		0.5	

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Kooperace/ Cooperation	MIT/ CMZRB	Assistance to establishment and development of SMEs co-operative association in order to strengthen their position on the market.	• SMEs up to 250 employees. • Entity is managing co-operative association of min. 20 members.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million; • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME)	• Grant of max. 50% for implementation of association intention up to EUR 28.6 thousand.		0.26	

Podpora Exportu/ Support of Export	MIT/ CzechTrade	Help SMEs with access to foreign markets.	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million; • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME).	• Grants for information marketing in the amount of 60% up to EUR 7.1 thousand; • Grants for education marketing in the amount of 60% up to EUR 1.4 thousand per year for courses organized or co-organized by CzechTrade; • Grants for design of promotion materials and internet pages in the amount of 60% up to EUR 10 thousand per year; • Grants for presentations, exhibitions and fairs in the amount of 60% up to EUR 5.7 thousand.		1.83	
Poradenství/ Counselling	MIT/ Business Development Agency	Enable to get financially advantageous guidance services, information and services of Innovation centers for SME.	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million; Independence (more than 25% cannot be owned by one company not fulfilling definition of SME).	• Grants for services of entrepreneur guidance 60% max. price of 1 hour is EUR 14.3; • Support of innovation firms in Business Innovation Centers (1st year 50%, 2nd year 40%, 3rd year 30%, from max. amounts for: rent yearly 69 EUR/m^2; other services 23 EUR/m^2); • Grants for entrepreneur training in the amount of 60%; • Grants for services of Association of women entrepreneurs and managers.	0.31	0.66	
Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Malé Pujčky/ Small Loans	MIT/ Business Development Agency	Creation of alternative sources of finances for small enterprises projects.	• SMEs up to 50 employees.	• Earnings EUR 7.1 million and property EUR 5.1 million; • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME).	• Loan from EUR 8.6-28.6 thousand, due in max. 4 years (structure of loan: investment into technologies min. 70%, purchase of know-how max. 30%, purchase of operational material max.30%, solution of temporary luck of liquidity max. 30%);	3	1	

Design	MIT/ Design center CR	Enable SMEs to develop analysis of production program from the view of quality of design.	• SMEs up to 250 employees.	• Earnings, resp. income under EUR 41 million and property under EUR 28 million; • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME).	• Independent expert review on the level of design (max. EUR 286); • Organizing of presentation of authors on the bases of recommendation of the Design Center CR (max. EUR 286); • Guidance services in design (max. EUR 14.3/hour max. 25 hours, EUR 357); • Grant for design services in the amount of 50%, max. EUR 1.7 thousand.		0.15	

Regional Business Support

START Program

The START program was announced by the resolution 898/2000 of the Government of the Czech Republic as partial measures to accompany the state programs for the re-structuralization of the Czech metallurgic industry. Its objective was to help some employees dismissed from the metallurgic industry in the Ostrava region and to facilitate the launching of their independent enterprise.

The START program belongs to the **priority axis of the support of enterprise (P2)**. With regard to the EU Principles of Cohesion policy, we can state:

Concentration: although the target of support was defined in terms of a particular industry (metallurgic industry), the implementation of the given program was highly concentrated (due to the concentration of the given industry in the Ostrava region).

Programming: in order to be eligible to receive support from the START program, it was not necessary to include one's entrepreneurial aim into any program document. The level of programming was, therefore null;

Partnership: partners in the implementation of support allocated on the basis of the START program were the MIT CR, metallurgic companies in Ostrava and private entrepreneurs recruiting from former employees of these companies. The programs therefore rely on the partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported entrepreneurial subject - the principle of additionality is thus fulfilled.

Transparency: the START program was approved by the Government, which also sets its rules (defining applicants eligible for support, conditions of support, the period during which the support is provided, the applying process etc.) and earmarks - based on the MIT CR proposal - financial means from the state budget. The MIT CR is responsible for the administration of these funds. The MIT also distributes and accepts applications for support. On the side of the state, the criteria and procedures of the support allocation are transparent enough, in reality; however, the given procedure is being criticized as rather laborious and lacking efficiency.

Until 1999, the support program called START ranked among the well-established instruments of nationwide support for small and medium-size enterprise, namely the support designed for emerging entrepreneurs all over the Czech Republic. In 2000, this program was adjusted from this original concept because of its relatively small success in the preceding several years (emerging entrepreneurs often represented a target group that was too risky both for commercial banks and the CMZRB). Only towards the end of 2000 did the new START program begin to be put into practice. This new program was divided according to individual industries (which also entailed their division by regions). The total amount of allocated funds was, however, very small (only EUR 163 thousand), and their use was even weaker, which was caused by the complicated administration of the program. Another problem resided in the fact that the program had just one objective; i.e., investment support where employees dismissed from the metallurgic industry were primarily in need of technical, legal and organizational assistance. A serious weakness of this program was also its doubling of the programs of active employment policy that, on a better organizational and material basis, tried to tackle the same social problem. There is general agreement that this program was brought into existence by political pressure. After 2001, its ineffectiveness became so blatantly evident that the program has been discontinued.

Reconstruction Program

The Reconstruction Program was announced by the resolution 470/2000 of the Government of the Czech Republic as one of the sets of measures aimed at helping regions afflicted by large floods in 1997. The program was amended in 1998 (its scope was extended to cover the territories afflicted by floods of 1998). In 2000, its application was subject to the resolution 1352/1999 of the Government of the Czech Republic. The objective of the program was, and still is, the support of entrepreneurial activities in the afflicted regions, both in large enterprises and medium-size and small ones.

The Reconstruction Program belongs to the **priority axis of the support of enterprise (P2)**. With regard to the EU Principles of Cohesion policy, we can state:

Concentration: the program is focused on small and medium-size entrepreneurs who were active in the territory of 27 districts afflicted by floods before 1997, or before 1998. The implementation of this program is thus rather strongly concentrated.

Programming: in order to be eligible to receive support from the START program, it was not necessary to include one's entrepreneurial aim into any program documents. Therefore, the level of programming was null.

Partnership: partners in the implementation of support allocated on the basis of the Reconstruction Program are; any entrepreneurial subject applying for support, a commercial bank providing credit, the CMZRB state bank, and the MIT CR. The programs thus rely on the partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported entrepreneurial subject. The principle of additionality is thus fulfilled.

Transparency: the Reconstruction Program was approved by the Government, which also sets its rules (defining applicants eligible for support, conditions of support, the period during which the support is provided, the application process, etc.) and earmarks, based on the MIT CR proposal, financial means from the state budget. The CMZRB state bank is responsible for the administration of these funds. This bank also distributes and accepts applications for support. On the side of the state, the criteria and procedures of the support allocation are thus transparent enough.

The Reconstruction Program was announced as one of the main instruments for solving the consequences of the floods of 1997 and 1998. In these two years, the largest amounts of financial means were also allocated to this program (total of EUR 28.6 million for the two years in question). The year 2000 brought a big cutback in the importance of this program. It was allocated financial means of EUR 3.7 million. Only twelve entrepreneurs made use of the support.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Millions)		
						EU	SB	Off-BF
START	MIT	Program of loans for business owned by employees released from metallurgical industry	• natural person • SMEs up to 50 employees, owned or part-owned by people released from metallurgical industry	Eligible Regions: List of metallurgic companies eligible for support (annex to the program Earnings EUR 7.1 million and property EUR 5.1 million) • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME)	• Non-interest loan max. EUR14.3 thousand for one released employee, max. EUR 85.7 thousand for one beneficiary , due max. in 6 years		0.16	

Rekonstrukce/ Reconstruction	MIT/ CMZRB	Creation of conditions for recovery of SMEs activity and industry companies, which were affected in 1997 and 1998 by floods[7]	• SME over 250 employees	Eligible Regions:
				Districts affected by floods
				• Contribution to interest payment to loans concluded from 1/7/1997, resp. from 1/7/1998
				• Affliction has to be proved by written record on damage from 1997 and 1998
				• Support only to loans:
				  • For building reconstruction
				  • Repairs and purchase of new machines , equipment and vehicles
				  • Purchase of damaged supplies and running costs with restart of enterprise
				  • For SME under 250 employees also to loans for coverage of temporary luck of running costs due to floods
					• Contribution to payment of interests in the amount of 4-10% loan interest (max. for 4 years, max. EUR 0.86 million)
					• Guarantee for rest of loan up to 50% loan principal and not paid interests not exceeding 30% of loan principal
							1.97	

			• SMEs up to 250 employees		• Contribution to payment of interests in the amount of 4-10% loan interest (max. for 4 years, max. EUR 0.29 million) • Guarantee for rest of loan up to 90% of loan principal and not paid interest not exceeding 30% of loan principal		1.77	

[7] Districts affected by floods in 1997 (Hradec Králové, Pardubice, Trutnov, Náchod, Rychnov nad Kněžnou, Ústí nad Orlicí, Svitavy, Blansko, Brno-město, Brno-venkov, Břeclav, Hodonín, Kroměříž, Uherské Hradiště, Zlín, Žďár nad Sázavou, Bruntál, Frýdek-Místek, Jeseník, Karviná, Nový Jičín, Olomouc, Opava, Ostrava-město, Přerov, Šumperk, Vsetín) and in 1998 (Rychnov nad Kněžnou, Náchod, Hradec Králové)

Programs of Support for Research and Development

The programs of the support of research and development include the following programs: Export, Centers, Stratech, Technos and Park.

All the programs shared the same characteristics in 2000:

- They had the same sponsor; i.e., the MIT CR;
- The quality of projects applying for support was evaluated by the same body; i.e., the Government Counsel for Research and Development;
- The programs shared the same procedure of announcing and evaluation; i.e., public competitive tenders;
- They shared the same objective; i.e., the support of innovative enterprise of small and medium-size businesses and support of industrial research and development;
- They shared the same instruments of support; i.e., the combined form of repayable financial assistance and non-repayable subsidies.

In spite of these common features, every single program in this group has some specific characteristics of content and procedures. According to this focus, this group can be subdivided into the programs Technos and Park. These provide support to research and developmental aims in medium-size and small businesses while strengthening cooperation between enterprises and research institutions. These two support programs for small and medium-size enterprises belong to the **priority axis of the support of enterprise (P2)**.

The remaining three programs were aimed at research and development of new products and technologies and at support of long-term cooperation between research institutions and (large) industrial enterprises. These three programs belong instead to the **priority axis of the development of human resources (P3)**.

With regard to the EU Principles of Cohesion policy, all the programs in this group share the same characteristics:

Concentration: this group of support programs is divided according to areas, their main objective is not to resolve inter-regional disparities. In this respect, the level of concentration is null;

Programming: in order to be eligible to receive support from the above-mentioned programs, it is still not necessary to include one's entrepreneurial aim into any program document. The level of programming is therefore null;

Partnership: partners in the implementation of support allocated on the basis of the given programs are an entrepreneurial subject applying for support, the Government Counsel for Research and Development as the evaluating institution and the MIT CR as the announcer of programs. The programs thus rely on the partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported entrepreneurial subject. The principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are announced by the MIT CR in the form of a competitive tender: this form ensures maximum transparency. The MIT CR publicly announces their rules (defining applicants eligible for support, the conditions of support, the period during which the support is provided, the application process, etc.) and supervises their formal observation. The Government Counsel for Research and Support performs qualified evaluations of projects applying for support. The MIT CR also subsidizes the given programs from the respective funds of its budget.

The Technos and Park programs have been used in the Czech Republic in almost the same versions since 1996, and the Export, Center and Stratech programs since 1998; their application is therefore quite well established and altogether successful. In 2000, the Technos program supported four developmental trends; new technologies, materials, products and information technologies. Altogether 26 new projects and 59 projects from previous years received support at the total cost of EUR 5 million. In 2000, the Park program supported the founding and operation of scientific and technological parks: nine new projects and five projects from previous years at the total cost of EUR 1.29 million. In the same year, approximately 254 projects in the category of the Export, Centers and Stratech programs were allocated EUR 32.7 million. Approximately two-thirds of this support was allocated to large industrial enterprises and research institutions.

In spite of the success achieved, this group of support programs has been criticized for its relatively small financial means and for its very strict conditions applied in public competitive tenders. As for the large number of applicants for this support, it is very difficult to comply with the formal aspects of these conditions.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
EXPORT	MIT	Enhancement of export capacity of Czech industry	• SMEs up to 250 employees	• Projects of innovative character where results can be expected at the latest in 3 years time from the beginning of support and return of investment up to 5 years	• Returnable financial support (up to 5 years) up to 75% the rest is up to applicant • Grant up to 50-75% for projects with results that will be used by more institutions, applicant has to assure up to 50%			
CENTRA/ CENTERS	MIT	Development of centers of top industrial products and technologies	• SMEs up to 250 employees	• Top technology projects fulfilling requirement of cooperation of industrial organizations with applied and basic research and will end with concrete implementation (prototype) up to 3 years from the beginning of support and return of investment at the latest in 5 years	• Returnable financial support (up to 5 years) up to 75% the rest is up to applicant • Grant up to 50-75% for projects with results that will be used by more institutions, applicant has to assure up to 50%		total 32.68 of which 13.54 for SMEs	
STRATECH	MIT	Support of strategic industrial technology of fields connected with covering the needs of defense and state security	• SMEs up to 250 employees	• Projects which will result in new research and development solutions and development solutions of products and technologies	• Returnable financial support (up to 5 years) up to 75% the rest is up to applicant • Grant up to 50-75% for projects with results that will be used by more institutions, applicant has to assure up to 50%			
TECHNOS	MIT	Industrial research and development project support	• SMEs up to 250 employees	• Independence (more than 25% cannot be owned by one company not fulfilling definition of SME)	• Returnable financial support (up to 5 years) up to 75% the rest is up to applicant • Grant up to 50-75% for projects with results that will be used by more institutions, applicant has to assure up to 50% • Max. support for one project is EUR 0.26 million		5.05	

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
PARK	MIT	Development of SME technique and technologies	• SMEs	• project has to be quality and complex and must comply with basic functions of hi-tech park • the applicant has to substantiate ownership or rent of land and buildings of hi-tech park for min. 10 years	• Returnable financial support (up to 5 years) up to 75% the rest is up to applicant • Grant up to 50-75% for projects with results that will be used by more institutions, applicant has to assure up to 50% • Max. support for one project is EUR 0.26 million		1.29	

Program for Support of Industrial Zones

The Program for the Support of Industrial Zones was initiated in 1998 as a supplement to the Program of Investment Stimuli (Law 72/2000 of the Collection). Its original objective was to assist municipalities in preparing industrial zones for large (usually foreign) investors, for whom the Program of Investment Stimuli was designed. The scope of the program had gradually expanded to cover the preparation of industrial zones for (Czech) small and medium-size entrepreneurs. The program is announced and funded by the MIT CR and administered by the Czech Agency for Foreign Investment, CzechInvest. The Land Fund of the Czech Republic also participates in the administration of the program, whose implementation usually includes transfers of ownership of land, designated for future industrial zones, from the state to a particular municipality. Support is awarded to municipalities (or to developmental agencies established by municipalities).

This program belongs to the **priority axis of the support of investment into infrastructure (P1)**. With regard to the EU Principles of Cohesion policy, it can be characterized:

Concentration: the main objective of the given program is not to reduce inter-regional disparities. In this respect, the level of concentration is null;

Programming: in order to be eligible to receive support within the framework of the given program, it is necessary that a particular zone is entered in the Land Plan of a respective municipality. It is an advantage, if the construction of a particular zone is included in the Program of Development of the given municipality. The level of programming is therefore relatively high;

Partnership: partners in the implementation of support allocated on the basis of respective programs are basically an entrepreneurial subject using the industrial zone in question (recruiting from large, medium-size and small enterprises), a municipality applying for support, CzechInvest, the MIT CR and the Land Fund of the Czech Republic. The programs thus firmly rely on the strategic partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported municipality. The principle of additionality is thus fulfilled.

Transparency: the program shows partial transparency, especially if the industrial zone is prepared for a well-known (usually large) investor who has selected that particular locality in advance. In such a case, other prospective investors from other localities are de facto excluded from the program. This applies to approximately one-half of the supported projects. In other cases, if the industrial zone is prepared for future unknown investors, localities (and supported municipalities as well) are selected in competitive tenders, and therefore, in a sufficiently transparent way.

In 2000, the program of support of industrial zones was divided into four mutually interrelated sub-programs: the preparation of industrial zones, the regeneration of industrial zones, the construction and reconstruction of manufacturing halls; and the accreditation of industrial zones. In the given year, within the framework of the program, CzechInvest provided municipalities with investment subsidies of EUR 11.2 million. These financial means were used to fund the preparation of 34 industrial zones, of which 15 zones were designed for large investors selected in advance. The remaining zones were designed particularly for small and medium-size businesses. Altogether, 819.4 hectares of industrial zones were prepared, of which 530.9 hectares represented the so-called developmental areas for unknown future investors (in the beginning of 2001, the actual occupation of these areas, however, was only approximately 25 percent).

Ultimately, users, municipalities and CzechInvest consider this program efficient. However, there is a latent conflict between the endeavor of municipalities to support a larger number of smaller zones and the endeavor of CzechInvest to concentrate resources into a smaller number of large and perfectly prepared localities.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Program of the support of industrial zones	MIT/ CzechInvest	Prepare conditions for development of capital construction	• Municipalities, regions and possibly development companies (= stock company enterprising in the field of real-estate development and tenancy)	• Preparation of industrial zones	• Grant for payment of bank loan interests (in form of non returnable financial support or in form of direct support) • Financing of 75% of bank loan interest for purchase of loan and at the same time direct support for payment of 60% of investment costs of building and technological part of building		11.24	
			• Municipalities, regions and possibly development companies (= stock company enterprising in the field of real-estate development and tenancy)	• Regeneration of industrial zones	• Grant for payment of bank loan interests (in form of non returnable financial support or in form of direct support) • Financing of 75% of bank loan interest for purchase of loan and at the same time direct support for payment of 75% of investment costs of building and technological part of building			
			• Development companies (= stock company enterprising in the field of real-estate development and tenancy)	• Construction and reconstruction of production halls connected with or integrated with in-store and administrative part, with production space of up to 5,000 m^2, or connection of the hall with technical facility area	• Grant to pay 75% of bank guarantee interest • Up to 30% of investment into construction part of building in industrial zone, max. EUR 0.6 million			
			• Municipalities, regions or by them nominated natural or legal persons	• Accreditation of industrial zones (participants at training provided by set organization, purchase of technical equipment, software and preparation of industrial zones marketing materials)	• Grant up to EUR 11.4 thousand for payment of up to 80% of investment costs			

Program for Support of Energy Saving and for the Use of Renewable Resources

The Program for the Support of Energy Saving belongs to the well-established support instruments of the state energy policy administered by the MIT CR. Since 1995, based on the authorization by the MIT CR, these programs have been annually announced and administered by the Czech Energy Agency (CEA, an organization subordinate to the MIT CR) that receives resources for these programs from the MIT CR budget. Support is provided in the form of subsidies and is distributed both to enterprises, public institutions, municipalities and citizens.

The programs belong to the **priority axis of the support of enterprise (P2)**. With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: the main objective of the given program is not to resolve inter-regional disparities. In this respect, the level of concentration is null;

Programming: the entire support program is linked to the State Program of the Support of Energy Saving and of the Use of Renewable Sources of Energy and, in accordance with this program, it is subdivided into ten specifically targeted sub-programs. In order to be eligible to receive support within the framework of a respective program, it is necessary for a particular project to correspond to one of the targets of these ten sub-programs, which formulate the priorities of the state energy policy. The level of programming is therefore relatively high;

Partnership: partners in the implementation of support allocated on the basis of respective programs are an entrepreneurial subject or a municipality applying for support, the CEA and the MIT CR. The programs thus firmly rely on the strategic partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported company or a municipality. The principle of additionality is thus fulfilled.

Transparency: formally, the program is completely transparent. The large number of sub-programs and their strict conditions, however, make the program rather complicated for applicants.

Among the ten sub-programs implemented in 2000, the largest amount of funds was used to fund the Program of the State Support of Energy Saving in Industry, Transport and Agriculture. The support amounted to EUR 2.9 million with 42 supported projects submitted by small and medium-size entrepreneurs (the energy hereby saved is presumably 20 thousand GJ). Other significant sub-programs were the Program for the State Support of the Optimized Energy Distribution to Housing Estates (EUR 0.5 million, 16 projects submitted by small and medium-size businesses, the energy hereby saved is presumably 24 thousand GJ), and the Program for the State Support of the Improved Use of Renewable and Secondary Sources of Energy (EUR 0.4 million, 23 projects submitted by small and medium-size businesses, the acquired energy output was 5.1 ths. kW). The following seven sub-programs received EUR 2.5 million. A large number of these programs focus on the support of the economical operation of buildings used for education, health care and other public services. Municipalities can benefit from non-investment subsidies designed for acquiring energy concepts, while the citizens represent the target group of the sub-program of economical operation of tenement houses and family houses.

The evaluation of the given group of sub-programs is altogether very positive, critical remarks are concerned only with a small amount of financial means provided by the CEA (in 2000 it was EUR 6.3 million). This small amount does not correspond to the importance of the issue of saving energy. This also implies that the support provided to users (i.e., inhabitants) represents only a very small amount.

NAME OF PROGRAM: Program for Support of Energy Saving and Use of Renewable Resources		
Responsible Authority		MIT/CEA
Objective of program		Application of energetic austerity measures in the production, distribution, energy consumption area and support to higher usage of renewable and secondary resources with the aim to reduce energetic austerity of economy, saving of energetic sources and minimization of pollution emissions´ impact on environment
Final beneficiary		• Producer and distributor of energy • State or regional body and municipality
Program conditions		• Drafting of energetic audit • Compliance all construction processes with State standards
Incentives		• Investment grants up to EUR143 thousand depending on type of project. • Grant up to 50% for projects, average level of support is about 30%
Financial resources (EUR million)	EU	
	SB	Total 6.3 of which 3.8 for SMEs
	Off-BF	

Programs for Support of Risk Capital

In 2000, there existed two programs for the support of risk capital in the Czech Republic. Both of them were connected to the resources of the Foundation for Local Development that was founded by the Ministry of Regional Development of the Czech Republic (MRD CR) and by the Delegation of the Commission of European Communities in Prague (DCEC) and relied on the support of the PHARE program. The first is the program administered by the Fund for Risk Capital Ltd. (the Foundation's subsidiary company). The second program is the program administered by the Czech Venture Partners Ltd. that administers three funds of risk capital (the Regional Entrepreneurial Fund, the Czech-Moravian Fund and the Czech Private Equity Fund), the investors of which are the above-mentioned Foundation on one hand, and banks (ING, ČSOB, EBRD) on the other hand.

These programs support entrepreneurial aims with a higher risk level and with a higher potential rate of profit. The mechanism of the support relies on a commercial basis, but the participation of public financial means in the support of entrepreneurial aims, slightly raises the accepted level of their risk. However, the principal advantage for the supported projects lies in the greater willingness of commercial banks to provide credit-based support to a particular aim (the division of risks). The basic instrument of support is the raising of registered capital of the supported enterprise related to the acquisition of trading shares that are eventually sold off (following the successful completion of an entrepreneurial aim).

Both programs belong to the **priority axis of the support of enterprise (P2).** With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: the main objective of the given program is not to reduce inter-regional disparities. In this respect, the level of concentration is null;

Programming: in order to be eligible to receive support from either of the programs, it is not necessary to include one's entrepreneurial aim into any program document. The level of programming is therefore null.

Partnership: partners in the implementation of support allocated on the basis of respective programs are; an entrepreneurial subject applying for support and one of administrating organizations that partly administer public funds. The programs therefore strongly rely on the strategic partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported company or a municipality. The principle of additionality is thus fulfilled.

Transparency: the program is fully transparent. It is based strictly on market evaluation of the quality of projects. Owing to an enormous preponderance of requests for this sort of support of enterprise, its transparency is largely formal.

Considering the serious lack of risk capital in the Czech Republic, the conditions of the programs administered by both funds are set to be very strict. In 2000, support was provided to investments ranging between EUR 0.29-1.71 million. The income from the investment was required to be at least 25 percent, the entry of the risk capital between 5-7 years and the above-mentioned administering organizations were required to be represented in statutory bodies of the supported company. At the same time, both funds administer quite small amounts of capital (e.g., the Czech Venture Partners administers EUR 48.6 million). All these facts indicate that the support effect of the given programs is very limited.

NAME OF PROGRAM: Fund for Risk Capital		
Responsible Authority		MRD+DCEC, Prague/Foundation for Local Development
Objective of program		Generation of high return of investment in the form of risk capital into SMEs
Final beneficiary		Private enterprises
Program conditions		• SME is managed by quality management team • Development potential, SME innovative character • Initial phase of SME or expansion
Incentives		Raise of company capital connected with acquisition of business share up to EUR 0.29 million
Financial resources (EUR million)	EU	EUR 3 million
	SB	
	Off-BF	
NAME OF PROGRAM: Czech Venture Partners		
Responsible Authority		Foundation for Local Development + PHARE, ING, ČSOB, EBRD
Objective of program		Location of investment possibilities for risk capital investors
Final beneficiary		Private enterprises
Program conditions		• Quality management team • Potential of dynamic growth • Company long term sustainable competitive advantages • Clear ownership structure
Incentives		Investment EUR 0.29-1.71 million, revenue min. 25%, representation in statutory body, outcome 5-7 years minority share in the company
Financial resources (EUR million)	EU	1.89
	SB	
	Off-BF	

EU Programs for Small and Medium-Size Businesses

The year 2000 was the last year in which the Third Multi-Year Program of Small and Medium-Size Businesses in the European Union (1997-2000) was administered. This program was also open to the associated countries, which included the Czech Republic. Within the framework of the Third Multi-Year Program of Small and Medium-Size Businesses in the European Union, the application of five specific support programs was approved for the Czech Republic. These are namely; the Euro Info Correspondence Centers, Europartenariat, Interprise, Crafts and Small Enterprises and Distributive Trade.

All the above-mentioned programs share the same objectives; i.e., the support of small and medium-size enterprise, the same approach to the covering of expenditures (50 percent of the expenditure on supported projects is covered by the entrance contribution paid by the Czech Republic to the European Commission, the remaining 50 percent has to be covered either by the project holder, or by sponsor's contribution or by the funds of the PHARE program) and the identical character of support (mostly non-investment assistance).

The administration of the given programs, however, shows certain differences: the Euro Info Correspondence Centers are administered by the respective Correspondence Euro Info Center at the MRD CR; the Distributive Trade is administered by the Union of Trade of the Czech Republic; and the remaining programs are administered by the Chamber of Commerce of the Czech Republic.

All the programs belong to the **priority axis of the support of enterprise (P2).** With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: the main objective of the given program is not to reduce inter-regional disparities. In this respect, the level of concentration is null;

Programming: in order to be eligible to receive support from any of these programs, it is not necessary to include one's entrepreneurial aim into any program document. The level of programming is therefore null.

Partnership: partners in the implementation of support allocated on the basis of respective programs are an entrepreneurial subject applying for support, and one of the administrating organizations that partly administer the EU public funds. The programs therefore strongly rely on the strategic partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported company or a municipality. The principle of additionality is thus fulfilled.

Transparency: the program is fully transparent.

The main profit from the administration of the given programs in the Czech Republic issues from the fact that administrating organizations acquire experience from the operation of European structures and participating small and medium-size companies acquire a number of useful contacts. The import of these programs was, however, limited by their small scopes: the Euro Info Correspondence Centers program was subsidized by the amount of EUR 171.4 thousand in 2000, the Europartenariat and Interprise programs altogether received EUR 77.1 thousand. The Crafts and Small Enterprises and Distributive Trade programs have not been launched at all due to the lack of interest on the part of Czech entrepreneurs.

Name of program	Responsible Authority	Objective of program	Final beneficiary	Program conditions	Incentives	Financial resources (EUR million)		
						EU	SB	off-BF
Euro Info Correspondence Centers	Euro Info Correspondence Centers within CRD/MRD	Information support to SMEs	SMEs	50% will be financed from CZ entry ticket paid to EC, 50% will be paid by beneficiary, sponsors or PHARE	• Free information and counseling • Direct connection to EC and all members of Euro Info Center network • Internet access to the databases available only to Euro Info Center members	0.04	0.13	
Europartenariat	Czech Chamber of Commerce	Support to SMEs from insufficiently developed areas to prepare agreements on technical, financial or business co-operation with foreign SMEs	SMEs	50% will be financed from CZ entry ticket paid to EC, 50% will be paid by beneficiary, sponsors or PHARE	• Support of participation of SMEs in Europartenariats in Denmark and Sicily (Italy)	0.05	0.03	
Interprise	Czech Chamber of Commerce	Support of partnership in the field of industry and services in Europe (support to local, regional and national SME initiatives)	SMEs	50% will be financed from CZ entry ticket paid to EC, 50% will be paid by beneficiary, sponsors or PHARE	• Possibility to take part in Interprise Europartner NRW 2000 activity, that was organized in the frame of Interprise program in North Rhineland-Westphalia			
Crafts and Small Enterprises	Czech Chamber of Commerce	Support to craft and small enterprise by creation of favorable business environment (women, young entrepreneurs, minorities)	SMEs	50% will be financed from CZ entry ticket paid to EC, 50% will be paid by beneficiary, sponsors or PHARE			Not launched in 2000	
Distributive Trade	Union of Trade	Preparation of SMEs from business sector for conditions of free market within the EU (less developed urban and suburb areas)	SMEs	50% will be financed from CZ entry ticket paid to EC, 50% will be paid by beneficiary, sponsors or PHARE				

Programs for the Support of Participation in Trade Fairs and Expositions and of the Support of Propagation Activities

The Programs of the Support of Participation in Trade Fairs and of the Support of Propagation Activities were first announced by the MIT CR in 1999 as a part of complex measures taken in support of the so-called Pro-Export Policy of the Government of the Czech Republic. Their objective is to improve the propagation and presentation of Czech products abroad.

The programs belong to the **priority axis of the support of enterprise (P2)**. With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: the main objective of the given program is not to reduce inter-regional disparities. In this respect, the level of concentration is null;

Programming: the entire support program is subject to the Pro-Export Policy document. Supported events are evaluated against this document. The level of programming is therefore relatively high;

Partnership: partners in the implementation of the support allocated on the basis of respective programs are; an entrepreneurial subject or a municipality applying for support, and the MIT CR. Formally, tthe programs therefore rely on the partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported company or a municipality. The principle of additionality is thus fulfilled.

Transparency: formally, the program is fully transparent.

In 2000, the Ministry of Industry and Trade funded 79 Czech official presentations in international trade fairs and expositions altogether, and two individual expositions abroad. Approximately 1,204 Czech entrepreneurial subjects participated in these events. Within the framework of its technical assistance, the Ministry of Industry and Trade paid 50 percent of the rent of clear exposition spaces in Europe to exhibitors with a staff of over 50 employees, and for 90 percent of the rent of clear exposition spaces to exhibitors with staff under 50 employees. Outside Europe and for an individual exposition, all the expositors received a 90 percent contribution, up to the maximum amount of EUR 2.9 thousand. One hundred percent of the expenditure on accompanying propagation materials was covered. This includes, among other things, the architectural design of an exposition, advertising in press and the organization of press conferences. The exhibitors were also equipped with propagation materials about the Czech Republic. The participation of small and medium-size enterprises in trade fairs represented 70 percent of Czech participation. Large companies represented the remaining part of exhibitors. The participation cost EUR 4.7 million altogether, of which the small and medium-size enterprise received EUR 3.3 million.

4.2.2 MINISTRY FOR REGIONAL DEVELOPMENT (MRD)

Programs of the Financial Regional Support of Small and Medium-Size Enterprise

The programs of financial regional support of small and medium-size enterprise include the following programs:

- Region – a program of support of small and medium-size enterprise in selected regions;
- Village – a program of support of small and medium-size enterprise in villages up to 1,999 inhabitants;
- Regeneration – a program of support of enterprise in national heritage reservations and zones;
- Preference – a program of providing credits for small businesses located in the territory of structurally afflicted regions;

- Operation – a program on the operation of small businesses located in selected regions;
- Border – a program of credits for small businesses located in the border areas.

All the above-mentioned programs shared the same characteristics in 2000:
- They were announced through a single resolution of the Government of the Czech Republic (1352/1999);
- They had the same sponsor; i.e., the MRD CR;
- They were all administered by the same institution; i.e., the CMZRB bank.
- They all shared the same objective; i.e., support to entrepreneurial aims of small and medium-size businesses in individual types of problem regions and locations;
- All the programs are characterized by the same instruments of support; e.g., providing guarantee, favorable credits or reimbursement of a part of interests from commercial credits.

All the programs of the financial regional support of small and medium-size enterprise belong to the **priority axis of the support of enterprise (P2).** With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: as apparent from the title of this group of support programs, their main objective is to reduce inter-regional disparities. In this respect, the level of concentration is relatively high, even though the concentration differs from one program to another (the Regeneration program shows the maximum level, whereas the Village program shows a relatively low level).

Programming: in order to be eligible to receive support from any of the above-mentioned programs, it has not been necessary so far to include one's entrepreneurial aim into any program document - the level of programming is therefore, null.

Partnership: partners in the implementation of support allocated on the basis of respective programs are; an entrepreneurial subject applying for support, a commercial bank providing credits, the CMZRB state bank and the MRD CR. The programs thus rely on the partnership of the private and public sectors.

Additionality: participation in a program is conditioned by co-funding on the part of a supported entrepreneurial subject. The principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are approved by the Government, which also sets their rules (defining eligibility for applicants, conditions of support, the period during which the support is provided, the application process, etc.) and earmarks, based on the MRD CR proposal, financial means from the state budget. The CMZRB bank is responsible for the administration of these funds. This bank also distributes and accepts applications for support. On the side of the state, the criteria and procedures of the support allocation are thus transparent enough. In reality, however, the equal access of applicants is complicated by two factors:

a) Applications for support are accepted only until the disposable resources of the CMZRB are exhausted, which bestows a campaign-like character upon the support allocation system (most of the programs are implemented in the first months of the year),
b) The support allocation presupposes that the entrepreneurial aim is accepted by a particular commercial bank, which frequently disqualifies those entrepreneurial aims that show a high degree of risk.

The six above-mentioned regional support programs may still be announced independently, in reality, however, the overwhelming majority of applicants for support make use of the opportunity to combine the advantages of these programs with the advantages of nationwide programs of support of small and medium-size enterprise. In evaluating the two large groups of programs, it is therefore very difficult to separate one from the other. In 2000, the regional support of enterprises in structurally afflicted and economically weak regions (i.e., the Region, Preference and Operation programs), in small villages up to 1,999 inhabitants (i.e., the Village and Operation programs) and in national heritage reservations (i.e., the Regeneration program) received the earmarked amount of EUR5.7 million. In addition, a larger part of the income and of the so-called *returns* (income from deposit accounts, payment of credits, repaid or unused contracting means etc.) amounted EUR 2.8 million, and EUR 2.4 million drawn from the MIT CR resources. The total amount of regional resources was EUR10.9 million, and was completely used up providing 433 regional supports. of this number, 59 contributions were provided to cover interest at the cost of EUR1 million, in order to settle applications from 1999. In comparison to 1999, the number of supports awarded in 2000 rose by 37 (index 109.3 percent), but the amount distributed was smaller by EUR 0.6 million (index 94.9 percent). Total value of supported entrepreneurial projects exceeded EUR 74.3 million. Regional programs of the support of enterprise contributed to creating 1,017 new job vacancies.

If we compare regional support and nationwide support, we see that within the framework of the regional programs, 17.5 percent of resources were used up, the share of the expenditures of projects supported amounted to 21.3 percent, the share of regional projects supported amounted to 29.4 percent and the share of promised new job vacancies reached 65.4 percent. The regional support of enterprise therefore fulfills its basic objective in creating new jobs in problem regions.

The largest number of regional grants (73) were awarded to the Brno region, the largest amount (EUR 2.94 million) was given to the Ostrava region. In these two regions, there will be also the largest number of newly created job vacancies. Also other regions (e.g., Ústí n. Labem and Olomouc), along with districts receiving targeted state support, seem to be relatively successful in gaining the state support, and in creating job vacancies. The Prague and Liberec regions, as well as others, on the contrary, show a rather small level of participation in regional programs.

In evaluating the present system of grant programs, however, we also meet with criticism. This criticism is aimed at the great fragmentation of programs disposing of disproportionately small funds and at complicated procedures (especially for small and emerging enterprises) in obtaining support and, finally, the instability of programs whose particular conditions have always been derived from funds available from annual state budgets.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Region	MRD/ CMZRB	Enhancement of attractiveness of small business and employment in regions	SMEs up to 50 employees	Eligible Regions: Structurally afflicted + economically weak regions • Earnings: EUR 7.1 million and property EUR 5.1 million • Independence; (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 2 people	Contribution for payment of interest; in structurally affected regions, 12% of interest from loan; in economically weak regions 7% of interests from loan (max. for 4 years; max. loan or supported part EUR 0.57 million) Regional guarantees in Ostravsko region		5.96	
Vesnice/ Village	MRD/ CMZRB	Enhancement of attractiveness of SMEs and employment in villages with up to 1,999 inhabitants (and in village Mladá)	Municipalities up to 1,999 inhabitants SMEs up to 250 employees	Eligible Regions: Municipalities up to 1,999 inhabitants + municipality Mladá in military training field Milovice • Earnings, resp. incomes under EUR 41 million and property under EUR 28 million • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 1 person	Contribution 6% of interest from bank loan (up to 4 years, max. loan or supported part EUR 0.57 million)		1.69	
Regenerace/ Regeneration	MRD/ CMZRB	Support to development of small business in commemoration areas (urban conservation areas, village type conservation areas urban conservation zones and conservation zones of urban type and in buildings listed in central list of cultural commemoration of Czech republic)	SMEs up to 50 employees	Eligible Regions: Cultural heritages areas • Earnings: EUR 7.1 million and property EUR 5.1 million • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 2 people	Contribution of 3% to pay interests from bank loan (up to 4 years, up to loan amount of EUR 0.57 million)		0.33	

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Preference	MRD/ CMZRB	Enhancement of attractiveness of SMEs in structurally affected regions (through investment targeted loans for implementation of small entrepreneurs´ objectives	SMEs up to 25 employees	Eligible Regions: Structurally afflicted regions • Earnings EUR 7.1 million and property EUR 5.1 million • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 2 people	Loan for implementation of business intention (up to amount of EUR 142.9 thousand, max. 6 years, interest rate is 5%)		2.73	
Provoz/ Operation	MRD/ CMZRB	Support to preservation and further development of small business (through operational loans for implementation of small entrepreneurs´ objectives)	SMEs up to 50 employees	Eligible Regions: Structurally afflicted + economically weak regions or municipalities up to 1,999 inhabitants • Earnings EUR 7.1 million and property EUR 5.1 million • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 1 person or employment of at least of 10 full time employees	Loan for purchase of supplies and for bypass of financial needs until settlement of outstanding accounts till due date (up to amount of EUR 28.6 thousand, due date max. 2 years, interest rate is 10%)		0.22	

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Hranice/ Border	MRD/ CMZRB	Enhancement of attractiveness of small business and employment in board areas	SMEs up to 50 employees	Eligible Regions: set border areas (borders with Germany - Euroregions Nisa, Labe, Krušné hory, Egrensis and Šumava, with Austria - districts Ceské Budejovice, Jindřichův Hradec, Třebíč, Břeclav, Brno-město, Český Krumlov, Jihlava, Znojmo, Hodonín, Brno-venkov). • Earnings EUR 7.1 million and property EUR 5.1 million • Independence (more than 25% cannot be owned by one company not fulfilling definition of SME) • Increase of number of employees by min. 2 people • Co-operation with foreign partner (according to definition of INTERREG in Germany or in Austria) • During the time of support execute export of goods or services min. in the amount of 10% of program annual revenue • Min. 10% of loan used for purchase of know-how, machines, equipment and vehicles from above state foreign suppliers	Loan for implementation of business intention (up to amount of EUR 0.2 million, max. 6 years, interest rate is 7%)		No disbu rse-ment	

Regional Support Programs

In 2000, there existed three complex programs aimed at the support of development in selected regions in the Czech Republic. These were namely:

- the Regional Program for Development of Northwest Bohemia and Ostrava Regions (including the sub-programs / the Subsidy Funds Investment Preparation of Industrial Areas and Buildings for Enterprise, Revitalization and Animation of Out-Dated and Unused Industrial Areas, the Support of Investment into the Development of Tourism);
- the Regional Support Program for Economically Weak and Structurally Affected Regions (including the sub-programs / subsidy funds Investment Preparation of Industrial Areas and Buildings for Enterprise, Revitalization and Animation of Out-Dated and Unused Industrial Areas, the Support of Investment for the Development of Tourism);
- the Regional Support Program for Reconstruction and Building of Technical Infrastructure In the Ralsko and Mladá Former Military Areas.

All the above-mentioned programs shared the same characteristics in 2000:

- They were all sponsored and administered by the same organization; i.e., the MRD CR;
- They all shared the same objective; i.e., the support and equalization of territorial and technical disproportion of available facilities in problem regions;
- The only recipients of support were municipalities in selected regions;
- All the programs are characterized by the same instruments of support; i.e., the targeted investment subsidy.

All above-mentioned regional support programs belong to the **priority axis of the support of investment into infrastructure (P1)**. With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: as apparent from the title of this group of support programs, their main objective is to reduce inter-regional disparities. In this respect, the level of concentration is relatively high even though concentration differs from one program to another (it reaches the maximum level in the Ralsko and Mladá regional support program, whereas it is relatively low, for instance, in the Development of the NUTS II Regions program).

Programming: in order to be eligible to receive support within the framework of the given program, it is necessary to demonstrate compatibility between the regional planning documentation and the proposed investment project. In addition to this condition, the entrepreneurial aim is not required to be included in any local or regional programming document. The level of programming is therefore very low.

Partnership: partners in the implementation of support allocated on the basis of respective programs are a municipality and the MRD CR. The programs therefore do not rely on the partnership of the public and private sectors;

Additionality: participation in the program is conditioned by co-funding from the side of a supported entrepreneurial subject. The principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are publicly and duly announced by the MRD CR, which also sets their rules (defining eligibility for applicants of support, the conditions of support, the period during which the support is provided, the application process, etc.) and earmarks financial means from its budget. The MRD CR is responsible for the administration of these funds. It also distributes and accepts applications for support. On the part of the state, the criteria and procedures of the support allocation are therefore transparent enough. In reality, however, the equal access of applicants is complicated by two factors:

a) applications for support are accepted only until the disposable MRD CR resources are exhausted, which bestows a campaign-like character upon the support allocation system (most of the programs are implemented in the first months of the year),
b) the support allocation presupposes that the project is co-funded, which handicaps especially small and poor municipalities.

The forms of the support of infrastructure conditions of enterprise in problem regions underwent numerous transformations in the Czech Republic in the course of the 1990´s. Equally unfixed was the definition of problem regions and their own determination. The three above-mentioned complex regional programs of support were first introduced, as described above, in 2000. It is therefore understandable that it was difficult for these programs to receive feedback even in the supported regions themselves. For this reason, the effects of the grants have still not become quite manifest. The main reason for this, perhaps, is the relatively small amount of financial means distributed by the programs (for the Northwest and Ostrava regions the support represented EUR 7.8 million, for the economically weak and structurally afflicted regions EUR 0.6 million , and for the Ralsko - Mladá region EUR 1.4 million .

With respect to the fact that this support is directed at the construction of infrastructure (i.e., projects that are quite expensive and are characterized by long periods of returns), all three programs share one serious weak point: their insufficient interconnectedness to program documents of the development of supported regions. This entails the lack of clearly stated priorities that could facilitate the selective process. The situation should improve by the future linking of these programs to the Joint Regional Operational Program (JROP). These two reasons, along with the annual funding of the programs, resulted in funds remaining from the already small financial means designated for support.

In 2000, a Regional support program was also announced for industrial enterprises in Northwest Bohemia and Ostrava regions, fthe most problematic Czech regions, with the aim of supporting SMEs and increasing employment. Two other projects administered by the CMZRB were also defined for SMEs – the program Region 2 and program RegioGuarantee. The main tools of both programs were soft-loans and guarantees for loan balances. Programs of the regional financial support of small and medium-size enterprise belong to the **priority axis of the support of enterprise (P2).** Characteristics of these programs are comparable with above-mentioned programs of the regional financial support of SMEs.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR million)		
						EU	SB	Off-BF
Regional Program for Development of Northwest Bohemia and Ostrava Regions	MRD	Support to development of SMEs infrastructure, cut down unemployment and support to development in the field of tourism.	Municipality	Eligible Regions: NUTS II Northwest[8] and NUTS II Ostravsko[9]. Municipality has developed urban study or town planning documentation Grants: 1. Preparation of industrial plots and buildings for business activities and revitalization of unused industrial spaces 2. Construction of tourism related infrastructure/ Tourism development investment support.	Investment grants up to 70% of eligible costs, Min. project EUR 2.86 thousands.		7.75	
Regional Support Program for Economically Weak and Structurally Affected Regions	MRD	Support to development of infrastructure for small and medium enterprises, cut down of unemployment and support of intentions in the field of tourism. Grants: 1. Preparation of industrial plots and buildings for business activities and revitalization of unused industrial spaces 2. Construction of tourism related infrastructure/ Support of investment for development of tourism	Municipality	Eligible Regions: List of economically weak and structurally affected regions (annually specified by a Governmental resolution) Municipality has developed urban study or town planning documentation.	Investment grants up to 70% of eligible costs in National Parks and max. 50% in other areas. Min. project EUR 2.86 thousands.		0.57	
Regional Support Program for Industrial Enterprises in Northwest Bohemia and Ostrava Regions	MRD	Support to implementation of chosen projects with the aim to create new job places in NUTS II regions Ostravsko and Northwest	SMEs	Eligible Regions: NUTS II Northwest and NUTS II Ostravsko. Increase of number of employees (max. grant EUR 8.57 thousand for one created job place).	Investment grants up to 50% of eligible costs, Max. grant is EUR 571 thousands.		13.7	

8 Region NUTS II Northwest includes districts Děčín, Cheb, Chomutov, Karlovy Vary, Litoměřice, Louny, Most, Sokolov, Teplice, Ústí nad Labem
9 Region NUTS II Ostravsko includes districts Bruntál, Frýdek-Místek, Karviná, Nový Jičín, Opava a Ostrava

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR million)		
						EU	SB	Off-BF
Regional Support Program for Reconstruction and Building of Technical Infrastructure in the Ralsko and Mladá Former Military Areas	MRD	Functioning of privatized objects and broadening of investment suitable areas. Grants: Construction or reconstruction of municipal technical infrastructure (water-supply, sewerage, gas main, local communication, public lighting, orientation and information system).	Municipality	Eligible Regions: Former military training fields Mladá and Ralsko. Municipality has developed urban study or town planning documentation.	Investment grants up to 75% of eligible costs, Min. project EUR 2.86 thousands.		1.43	
Regiozáruka/ Regio Guarantee	MRD/ CMZRB	Facilitate implementation of promising business intentions	SMEs up to 250 employees	Eligible Regions: NUTS II Northwest and NUTS II Ostravsko. Earnings, resp. incomes under EUR 41 million and property under EUR 28 million; Independence (more than 25% cannot be owned by one company not fulfilling definition of SME); Increase of number of employees by min. 2 people.	Guarantee for loan balance up to 75% of loan principal and not paid interest up to 30% of loan principal balance. The price of guarantee is 0.9% p.a. from the amount of guarantee; entrepreneur pays only 0.4% p.a.		1.01	
Region 2	MRD/ CMZRB	Improve conditions for establishment and development of SMEs	SMEs up to 250 employees	Eligible Regions: NUTS II Northwest and NUTS II Ostravsko. Earnings, resp. incomes under EUR 41 million and property under EUR 28 million; Independence (more than 25% cannot be owned by one company not fulfilling definition of SME); Increase of number of employees by 1 person on each EUR 57.1 thousand	Soft loans - 9% interest rate subsidy, due date max. 4 years. Max. amount of loan or its supported part is EUR 1.46 million.		2.65	

Program for Revitalization of Countryside

The Program for Revitalization of Countryside is a well-established (since 1994) and complex rural development program in the Czech Republic. Its objective is to create organizational and economic conditions for the support of the country inhabitants and local governments so that they themselves would contribute to the harmonious development of a healthy environment, the maintenance of natural and cultural qualities of the countryside and the development of an ecology-friendly economy. It includes the following sub-programs:

- Reconstruction and maintenance of country estates and civic facilities;
- Complex treatment of public spaces;
- Recovery and maintenance of vegetation areas;
- Reconstruction of local communications, construction of cycling and foot paths, reconstruction and building of public lighting;
- Preparation of urban studies and urban plans;
- Education and counseling in the field of country development;
- Integrated projects of country micro-regions;
- Development of infrastructure;
- Technical infrastructure.

All the above-mentioned sub-programs have some common features:

- They are administered by the same organization; i.e., the MRD CR (except for the sub-program no. 9 in which the CBC-PHARE program participates and funds are provided by means of regional developmental agencies);
- They can allocate support only to municipalities (in principle those with less than 3,000 inhabitants, although most sub-programs prefer villages with less than 500 inhabitants). The other (private) subjects have to apply for support by way of a municipality and this municipality is also responsible for the effective use of the support;
- They share the same instrument of support; i.e., special investment grants (investment subsidies in the case of sub-programs nos. 1-5 and 9, non-investment subsidies in the case of sub-programs nos. 6-7), only in the case of the sub-program no. 8 is the support provided in the form of interest rate subsidy (up to 10 percent).

All the sub-programs of the Program for Revitalization of Countryside belong, either directly or indirectly, to the **priority axis of the support of investment into infrastructure (P1)**. With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: as apparent from the title, Program for Revitalization of Countryside, the main objective of this program is to restore the appeal of life and enterprise in country villages and also to eliminate certain disparities between the city and the country. Even though the program does not deal with the inter-regional disparity in the proper sense of the word, from this perspective the level of concentration is rather high.

Programming: in order to be eligible to receive support from any of the above-mentioned sub-programs, it is necessary to demonstrate compatibility between the regional planning documentation and the proposed investment project. Another (more general) condition is that the municipality applying for support can submit its own Revitalization program. In evaluating applications for support, preference is usually given to those investment and non-investment projects that are included in a previously elaborated Integrated Project for the Development of Micro-regions (subsidy title no. 7). Overall, the level of programming is therefore very high.

Partnership: the partners, in realizing the support provided on the basis of respective sub-programs, are a municipality and the MRD CR. Municipalities, or associations of municipalities, usually support their applications with local concept documents on the partnership between the private and public sectors (municipalities also apply for support on behalf of other subjects). Partnership, thus holds quite a strong position in the Program for Revitalization of Countryside, however mediated it is.

Additionality: participation in a program requires co-funding on the part of a supported municipality. The principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are publicly and duly announced by the MRD CR, which also sets their rules (defining applicant-eligibility for support, the conditions of support, the period during which the support is provided, the application process, etc.) and earmarks financial means from its budget. The MRD CR is responsible for the administration of these funds. It also distributes and accepts applications for support. The state criteria and procedures of support allocation are transparent enough. In reality, however, equal access of applicants is complicated by two factors:

a) applications for support are accepted only until the disposable MRD CR resources are exhausted, which bestows a campaign-like character upon the support allocation system,
b) particularly in the case of investment subsidies the demand by far exceeds the possibilities of the Program of revitalization of countryside - this situation opens up a space for lobbing on the side of municipalities.

During the seven years of its existence, the Program for Revitalization of Countryside has become one of the most popular support programs in the Czech Republic, in spite of the fact that it has rather limited resources. Over the last few years, the program annually administered EUR 14.3 million on average (for instance, in 2000, the figure was EUR16.2 million). The program has helped to improve the appearance and facilities in hundreds of Czech villages and contributed, thanks to the subsidy title no. 7, to the popularization of the (common) strategic planning of villages. In terms of its content and procedures, the program is gradually drawing near the conditions of the SAPARD program and it can be expected that, beginning in 2002, it will be also co-funded from the SAPARD program.

Name of Program	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR million)		
					EU	SB	Off-BF
Program for revitalization of countryside Responsible Authority: MRD	Create administrative and economical conditions for challenge and for support of countryside inhabitants and countryside village self-government. Development of farming while using local resources and employment of local inhabitants.	Municipality (may represents municipal association, NGOs and other entities) A. Grants for activities of local village recovery program. B. Grants for development of urban studies and town plans C. Grants for support of education and guidance. D. Grants for development of integrated projects of outlands micro-regions. E. Loans interest subsidy. F. Grants with support of PHARE CBC program.				total 16.19	
	A1 (1). Reconstruction of municipal or other public buildings (schools, health centers, churches, etc.)		Grant is given exclusively for purchase of municipality property; Municipality has developed urban study or town planning documentation; Municipality has approved local village recovery program that contains list of activities of local recovery program; Min. contribution for one activity is EUR 0.7 thousand, max. contribution for all activities is EUR 28.6 thousand; The municipality co-financing may be partly in kind (own material, free work of inhabitants).	Grant in the amount of 50% of yearly costs; in case of renewal of objects listed as cultural heritage max. 60% of yearly activity costs; for municipalities with less than 500 inhabitants and activities with total cost up to EUR 5.7 thousand, max. 60% of yearly activity costs.		6.51	
	A2 (2). Upgrading of public places/ Complex adaptation of public places.			Grant in the amount max. 30% yearly activity costs; In case of countryside cultural heritage and zones max 50% of yearly activity costs; for municipalities with less than 500 inhabitants and activities with total cost up to EUR 5.7 thousand, max. 60% of yearly activity costs.		0.71	

	A3 (3). Renewal and establishment of public greenery.			Grant in the amount of 50% of yearly costs; for municipalities with less than 500 inhabitants and activities with total cost up to EUR 5.7 thousand max. 60% of yearly activity costs.			
	A4. (4) Reconstruction of local roads, reconstruction and construction of public lights, building of cycle and walking path etc.			Grant in the amount up to 30% of yearly activity costs max. EUR 14.3 thousand, municipalities under 500 inhabitants and activity up to EUR 5.7 thousand, max 60% of yearly activity costs.		3.46	
	B1. (5) Development of urban studies and master plans.		In case of B1(5) grant scheme municipality can apply for grant in case it already received grant in the frame of the Program for activities of local recovery village program.	Grant in the amount up to 1/3 of costs of studies, analyses and concepts of town; for village cultural reservations and zones up to ½ of expenses but the amount of grant will be set on the bases of estimated costs for development		not launch-ed in 2000	
	C1. (6) Municipality projects for education and guidance in the field of countryside development.		The grant can be given only for projects targeted at training and guidance in the field of countryside development and renewal of village exceeding possibilities and necessities of municipality, generally of regional but also national importance (i.e., municipality renewal schools, advisors for more municipalities connected into Program etc.); Co-financing from municipality budgets or training courses participants in the amount of 30% of yearly costs must be ensured.	Grant in the amount of max 70% of yearly project costs.		3.63	
	D1. (7) Countryside micro-regions integrated projects (projects aiming at synergy among infrastructure, labor market policy, SMEs development, environmental care)		The projects will be used for getting further financial support, for example from EU (PHARE) and other foreign sources where is this approach usual. In case of coverage from this sources beneficiaries may be also other subjects (natural and legal persons) than municipalities	Grant in the amount of max 70% of yearly project costs.			

	E1. (8) Projects for infrastructure development		Municipality has developed urban study or town planning documentation Grant may be given to municipality with less than 3,000 inhabitants or also bigger if the activity concerns its local part with less than 3,000 inhabitants and total number of inhabitants is under 5,000. In case the same project gets grant for loan interests in more years, the max. total allotted is EUR 28.6 thousand.	Grant up to 10% of interest form loan for projects implementation, which has to be paid to bank by the municipality this year.		1.31	
	F1. (9) Technical infrastructure		Eligible Regions: border regions, (in case of cross-border effect, also in districts Brno-venkov, Hodonín, Jihlava, Semily and Třebíč; in case of agreement with German or Austrian side, also in other districts.) Municipality has developed urban study or town planning documentation; Municipality has approved local village recovery program that contains list of activities of local recovery program; Grant may be given to municipality with less than 3,000 inhabitants or also bigger if the activity concerns its local part with less than 3,000 inhabitants and total number of inhabitants is under 5,000.	In case of co-financing from PHARE municipalities can get form national sources from Municipality renewal program grant up to 30% of project costs, max. EUR 28.6 thousand in current year also for infrastructure activities. The total support of project from PHARE CBC sources may be max. 49% of total project costs. Minimal municipality contribution is 21%.		0.57	

CBC/PHARE Programs

The CBC/PHARE programs represent the first regional support programs in the Czech Republic fully funded from EU resources. The programs are administered by the CBC/PHARE Implementation Agency (Center for Regional Development). These are namely two programs:

- Large infrastructure projects (taking measures in the sphere of transport, technical infrastructure and protection of the environment). It administers 90 percent of the CBC/PHARE funds.
- Joint Small Project Fund (providing non-investment support of tourism, cultural and sports events and initiatives at schools and in education in general). It administers 10 percent of the CBC/PHARE funds.

Both programs have some common features:

- Supported projects must have *cross-border* effect;
- Support may be provided only to municipalities, associations of municipalities, district authorities, organizations with majority participation of municipalities or the state, non-profit organizations (entrepreneurial subjects are not eligible);
- Recipient of support must be based in locations adjoining the borders of the Czech Republic;
- Provided support represents a subsidy with 75 percent minimum CBC/PHARE participation.

The Large Infrastructure Projects program belongs to the **priority axis of the support of investment into infrastructure (P1)**. The Joint Small Projects Fund program belongs to the **priority axis of the development of human resources (P3)**. With regard to the EU Principles of Cohesion policy, they share the same characteristics:

Concentration: as apparent from the title of the CBC programs (cross-border cooperation), their main objective to improve cooperation between non-profit subjects in the Czech - German, Czech - Austrian and Czech - Polish border areas. Even though its main objective is not to reduce inter-regional disparities, in reality, it has exactly this effect. From this perspective, the level of concentration is therefore relatively high.

Programming: in order to be eligible to receive support from either of the above-mentioned programs, in 2000 it was not necessary to demonstrate compatibility with any regional planning documentation (beginning in 2002, it will probably be necessary to demonstrate compatibility with the priorities of EU and CR common program documents). On a whole, the level of programming was therefore very low.

Partnership: partners in implementing the support provided on the basis of respective programs are; a municipality, a municipal, state or other non-profit organization, and the Implementation Agency. These partners have to prove the cross-border effect of their project, which usually implies establishing cross-border partnerships (preference is given to the so-called *mirror projects*; i.e., those projects that are simultaneously submitted on both sides of the border). Partnership therefore occupies quite a strong position in the CBC programs, although it is only mediated.

Additionality: participation in a program is conditioned by co-funding from the side of a supported municipality. The principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are publicly and duly announced by the MRD CR and the Implementation Agency. The procedure of accepting and evaluating applications must comply with the Directives of the European Commission no. 276/98. Transparency of the criteria and the procedures of the support allocation are thus fully ensured.

Both CBC/PHARE programs have met with very positive reactions in the Czech border areas. This may be explained by the generous amount of support provided. In 2000, both programs administered EUR 19 million, of which EUR 10 million was assigned to the Czech - German border areas, EUR 5 million to the Czech - Polish border areas, and EUR 4 million to the Czech Austrian border areas. Also, the target of these programs, is to *open-up* border areas and establish contacts with neighbors. The program brought about one more positive side effect: Czech applicants had an opportunity to try out the usual procedures common in the application process for EU grants.

Name of program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR million)		
						EU	SB	Off-BF
Cross Border Cooperation	MRD/ CRD	Elimination of effects of former Iron Curtain in the sphere of infrastructure and mutual contacts.	Investor – municipality, municipal associations, district offices, state organizations, organizations with majority share of municipalities or state share, non-governmental organizations.	Eligible Regions: districts bordering with partner country (Germany, Austria and Poland) • Direct cross-border impact and strong support of partner country has to be demonstrated; • Projects must fulfill priorities set in Joint programming documents; • The investor must ensure at least 25% of the total project costs.	• Large Infrastructure Projects –LIP (90% project costs) in the field of transportation, infrastructure and environment; • Joint Small Project Fund –JSPF (10%) – projects of non-investment character (tourism, cultural and sporting events and initiatives in the field of education and training + financing of small infrastructure projects, repair of small historical, tourist important objects, etc.); • Max. CBC PHARE contribution is 75%; • LIP: minimum CBC PHARE contribution must EUR 2 million; • JSPF: max. CBC PHARE contribution to non-investment activities and also to small infrastructure projects is EUR 300 thousand.	19 (10 GER 5 POL, 4 AUS)	approx. 25% of project costs covered by investors	

Programs for the Support of Tourism

In 2000, there were no programs supporting tourism - the first program of this sort was launched only for the year of 2001. This is the Program for Development and Regeneration of the Spa Industry, announced and administered by the MRD CR in the form of four sub-programs.

Grants for Tourist Regions

In 2000, the only forms of support for tourism were the Grants for Tourist Regions awarded by the Czech Center of Tourism (CCT), a subordinate organization of the MRD CR. These grants were awarded within the framework of two Grant Programs:

- Regional Tourist Product (its objective is to contribute to tourist products of regional and super-regional import, particularly the funding of presentation and propagation of these products and the funding of small tourist infrastructure);
- Presentation of Regions (grants to fund the publishing of press materials presenting regions, presentation on the Internet and in expositions and trade fairs).

The two grant programs have some common features:

- The type of an applicant, either a municipality, an organization established by a municipality, or any other non-profit organization dealing with the development of tourism;
- The form of support; i.e., the grant (non-repayable subsidy) covering up to 50 percent of expenditures of the supported project.

Both grant programs belong - either directly or indirectly - to the **priority axis of the support of investment into infrastructure (P1)**. With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: the programs are understood to be nationwide. From this perspective, the level of concentration is therefore null.

Programming: in order to be eligible to receive support from either of the above-mentioned programs, it is not necessary to demonstrate compatibility with any planning documentation. The level of programming is thus null.

Partnership: the partners in implementing the support provided on the basis of respective programs are; a municipality or a non-profit organization, and the CCT. The principle of partnership is therefore rather limited.

Additionality: participation in a program is conditioned by co-funding from the side of a supported municipality. The principle of additionality is thus fulfilled.

Transparency: the grant programs are publicly and duly announced by the CCT, which also sets their rules (defining applicants eligible for support, conditions of support, the period during which the support is provided, the applying process etc.) and earmarks financial means from its budget. The programs are thus formally transparent enough.

The grant programs for the support of tourism play a rather secondary role in the development of this industry. This can be explained by; a rather limited amount of financial means administered by these grants (in 2000, it was EUR 0.62 million); a low level of general knowledge of this support source; but, primarily, by the fact that these grants cannot be awarded to entrepreneurial subjects who otherwise play a dominant role in tourism and administer much bigger financial means for the propagation of their products. The grant programs are therefore important in that respect that they disseminate information about less known tourist products and regions, which in the future may help to reduce the present concentration of tourism in a limited number of localities and regions.

Programs for the Support of Housing

In the Czech Republic, the support of housing is provided by means of a broad range of direct and indirect support programs. In 2000, the programs of *indirect* support were the Support of Building Savings and the Support of Mortgage Crediting. In 2000, the programs of *direct* support included: State Interest-Free Loan, Support for the Construction of Rental Apartments and Technical Infrastructure, Support for the Construction of Home Nursing Houses, Support for the Reconstruction of the Housing Fund, Support for the Reconstruction of Prefab Housing Estates.

The common feature of these two groups of support programs was that they were guaranteed and administered by the MRD CR (only towards the end of 2000 was the State Fund of the Housing Development (SFHD) established, which is supposed to take over the administration of programs of direct support).

For programs of indirect support, there is a banking institution (i.e., a savings bank, a mortgage bank) between the program guarantee and the ultimate user. The support is awarded in the form of a non-repayable state contribution (maximum of EUR128.6 per year) in the case of the building savings, or the reimbursement of a part of interests from mortgage credits (4 percent maximum). Expenditures on both programs were enormous: in 2000, the support of the building savings represented EUR 205.4 million and the support of mortgage crediting EUR 7.84 million. The state is obliged to cover these expenditures (as stipulated by law) though they depend rather on the fluctuation of the market than on the directions in the state housing policy. Therefore, they represent passive instruments and will not be analyzed in this text any further.

As far as programs of direct support are concerned, the State Interest-Free Loan created a sufficiently motivating instrument for the use of building savings and mortgage crediting programs for new redevelopment as it tried to assist young families in getting better access to housing. The efficiency of this instrument, however, proved to be relatively low (the 2000 program spent EUR 9.4 million) and no new applications for support were accepted.

The four remaining programs showed the following common features:

- Only municipalities were eligible to apply for support (except for the Program for the Support of the Reconstruction of the Housing Fund, where any owner was eligible to apply);
- Support was awarded according to the decision of the MRD and on the basis of a previously submitted expert evidence of district authorities;
- The instrument of support was a non-returnable targeted subsidy (except for the program of state loans for reconstruction, modernization and extension of housing estates, in which case it was an interest-free loan).

This program belongs to the **priority axis of the support of investment into infrastructure (P1)** and, with regard to the EU Principles of Cohesion policy, it shows these characteristics:

Concentration: the objective of the given program is not to reduce inter-regional disparities - from this perspective, the level of concentration is therefore null.

Programming: in order to be eligible to receive support from the above-mentioned program, it is not necessary for the project to be registered in the Program for Development of a respective municipality. The level of programming is therefore rather low.

Partnership: the partners in implementing the support provided on the basis of respective programs are a municipality (or another owner of an apartment building) and the MRD CR. Therefore, reliance on the partnership of the private and public sectors is very limited.

Additionality: participation in a program requires co-funding on the part of a supported municipality. The principle of additionality is thus fulfilled.

Transparency: formally, the program is completely transparent. However, due to limited resources of the MRD, the exceeding demand for the given grants opens up a big space for lobbying of individual applicants (municipalities).

The largest and, from the perspective of the construction of new (rental) apartments, the most effective, program is the Program for Support of the Construction of Rental Apartments and Technical Infrastructure. In 2000, within the framework of this program, municipalities received EUR 94.9 million altogether (the set limit of the state support is the maximum of EUR 9.1 thousand / apartment for the construction of rental apartments, and EUR 2.3 thousand / future apartment for the construction of technical infrastructure) and 3,200 apartments were built thanks to these subsidies. The second largest program was the Program of Support of the Construction of Home Nursing Houses. The allocated funds amounted to EUR 25.6 million (the maximum provided subsidy is EUR 20 thousand per apartment in a municipality with the maximum number of inhabitants of up to 10 thousand; EUR 17.1 thousand per apartment in a municipality with the number of inhabitants from 10 to 100 thousand; and EUR 14.3 thousand in municipalities with inhabitants over 100 thousand.) Compared to the situation in the mid-1990s, in 2000, this program showed a declining tendency as it reached only half of the original amount. Within the Program of Support for the Reconstruction of the Housing fund, EUR 15.2 million was distributed in the form of subsidies in 2000. Within the Program of state loans for reconstruction, modernization and extension of housing estates, it was EUR 8.6 million in the form of interest-free loans.

The programs offering direct support for the construction and maintenance of the housing fund met with enormous interest on the side of Czech municipalities (less on the side of other owners of the housing fund). This fact, however, does not allay the following criticism targeted at these programs:

- The excessive emphasis on the support of municipalities (other applicants and administrators of the housing fund, especially cooperatives and non-profit housing associations, are thus shunted);
- The campaign-like character and uncertainty accompanying the process of collecting and evaluating applications for support (applications must be submitted in the first months of the calendar year, the required documentation itself is quite expensive, the results are frequently announced only in the autumn of the same calendar year when it may be difficult to make use of the allocated support);
- The linking of the programs to the annual budgets of the MRD CR. (This problem was solved by establishing the State Fund of the Housing Development).

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Program of State Loans for Reconstruction, Modernization and Extension of Housing Estates	MRD	Improvement of status of housing fund.	municipality	State loan given to municipality payable in 10 years	Interest-free loan for municipalities		8.57	
Support for the Reconstruction of the Housing Fund	MRD	Support to owners of flat houses and flats built by prefab technology.	natural and legal persons owning houses or flats built in panel technology (municipalities, housing associates).		Non-returnable grant up to 40% of budgeted reconstruction costs.		15.23	
Support for the Construction of Rental Apartments and Technical Infrastructure	MRD/ SFHD	Create conditions for recovery of building of rental flats.	municipality	Building will be used for permanent rental housing for 20 years after acceptance.	Non-returnable grant in amount: • Grant of max. EUR 9.1 thousand for new apartments • Grant of max. EUR 5.7 thousand per reconstructed flat • Grant of max. EUR 2.3 thousand for technical infrastructure for one flat • Grant of max. EUR 10.6 thousand for one tenancy flat - reconstructed former army object in the possession of municipality • Grant max. EUR 14.3 thousand for one flat conditioned for handicapped people State support may be max. 50% of investment costs		82.4	12.51
Support for the Construction of Home Nursing Houses	MRD/ SFHD	Create conditions for quality and conformable housing of people with lower autarchy.	municipality	Tenancy flats built with this kind of grant have max. floor area of 50 m^2.	Non-returnable grant in amount: • Max. EUR 20 thousand for one flat in municipality with under 10 thousand inhabitants • max. EUR 17.1 thousand for one flat in municipality with 10 to 100 thousand inhabitants • max. EUR 14.3 thousand for one flat in municipality with over 100 thousand inhabitants		16.52	9.08

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
State Interest-Free Loan	MRD	Recovery of new housing construction and the possibility to get new flat for middle or slightly above average income families.	constructor or first owner of already built flat.	Financial resources (mortgage + own capital + eventual state loan) Building permission issued after 1/7/1997 Applicant earnings (his household) is not over 4x subsistence minimum.	Returnable state contribution, which reimburses monthly mortgage loan installment. Mortgage due latest in 10 years time Max. amount of loan is EUR 5.71 thousand.		9.4	

4.2.3 MINISTRY OF ENVIRONMENT (MOE)

Programs for the Protection of the Components of the Environment

The programs for the protection of the environment include the following programs:
- Programs for the Protection of the Waters (sub-programs: Middle Resources, Protection of the Sources of Drinking Water, Industrial Sources, Expansion and Intensification of Municipal Sewage Works, Expansion of Drainage Systems),
- Programs for the Protection of the Air (sub-programs: Reduction of Emissions of Air Pollutants in Small and Medium-size Sources of Pollution Used as an Instrument of Welfare Activities; Reduction of Emissions of Air Pollutants in Sources of Air Pollution; Use of Co-Generation Units; Development of the Infrastructure of Small Municipalities; Reduction of Emissions of Volatile Organic Substances; Protection of the Ozone Layer of the Earth; Reduction of Emissions and Emissive Overloading of Territories),
- Program for the Care of the Environment, Program for Garbage Handling (sub-programs: Recovery and Re-cultivation of Old Waste Dumps),
- Program of Technology and Production (sub-programs: the Best Available Technologies, Introduction of Management Systems and Audits with Respect to the Environment, Support of the Infrastructure of the Ecology-Friendly Public Transport),
- Program for the Support of Selected Coalfield Districts in Northwest Bohemia.

All the above-listed programs shared the same characteristics in 2000:
- They were announced by a single resolution of the minister of the environment on providing support from the State Fund of the Environment (SFE) for 2000;
- They were assigned by one organization; i.e., the Ministry of the Environment of the Czech Republic (ME CR);
- They were administered by one organization; i.e., the SFE (except for the Best Available Technologies program that is partly administered by the Czech Center of Clearer Production CPC, a civic association that is a member of the international network of clearer production, established under the auspices of the UNIDO and the UNEP);
- They share the same objective; i.e., the support of measures taken in order to improve the condition of components of the environment;
- They have the same target group of recipients of support; i.e., municipalities and non-profit organizations, entrepreneurial subjects and citizens;
- They have the same conditions for participation in the programs (however, each program and its component sub-programs have their own specific criteria for the evaluation of submitted projects);
- All the programs share the same instruments of support; i.e., a subsidy, a loan or the combination of a subsidy and a loan (the proportions of the use of these programs are always set individually according to the character of a particular project and its holder. Entrepreneurial subjects may also receive indirect support, which means the reimbursement of a part of interests from a commercial credit lodged for the funding of a supported project.

All the above-mentioned programs of the protection of the components of the environment belong - either directly or indirectly - to **the priority axis of the support of investment into infrastructure (P1)**. With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: except for the Program for the Support of Selected Coalfield Districts in Northwest Bohemia (which is a highly concentrated program), the other programs are announced as nationwide programs. From this perspective, the level of concentration is therefore null. On the other hand, it is true that the evaluation criteria set for all the sub-programs give preference to those projects that seem most beneficial for the improvement of the environment. From this perspective, the support is frequently awarded just to projects implemented in the territory of some of the most damaged regions (e.g., Northwest Bohemia and the Ostrava region).

Programming: in order to be eligible to receive support from any of the above-mentioned programs, it is not necessary to include one's aim in a program document. The level of programming is therefore null. In the case of an investment project, however, it is necessary to have it entered in the Land Plan. Priority areas (already reflected in the conditions for support) are based on the State Policy of the Environment.

Partnership: partners in the implementation of support allocated on the basis of the given programs are; a non-profit or entrepreneurial subject applying for support, the SFE, and the MOE CR. The programs thus rely on the partnership of the public and private sectors;

Additionality: participation in a program is conditioned by co-funding from the side of a supported non-profit or entrepreneurial subject. The principle of additionality is thus fulfilled.

Transparency: all the programs are approved by the MOE CR, which also sets their rules (defining applicant eligibility for support, conditions of support, the period during which the support is provided, the application process etc.). The actual amount of funds is determined by the possibilities of the SFE budget, whose autonomous income may be delegated by law (part of fees on pollution). However, the main source of funding of the given programs comes from occasional transfers of funds from the Fund of National Property, approved by the Parliament. This means that the SFE possibilities differ from one year to another and thus the chances of applicants for support are rather uneven. Formally, however, the selection procedure is completely transparent: the conditions of support are publicly and duly announced, the quality of applications is evaluated by independent councils of experts, the SFE Director's recommended project is confirmed by the Fund Council (composed of independent persons) and the contract on support is signed by the minister of the environment.

The programs for the protection of the components of the environment, administered by the SFE, are among the oldest support instruments in the Czech Republic. They have been in use since 1992. Since their launch, the contents and procedures have matured so that the programs are nowadays considered a standard component of the state environmental policy. The SFE CR income in 1992-2000 reached the total amount of EUR 1,037 million, out of which EUR 100 million formed the income in 2000. The SFE CR expenditures in 1992-2000 reached the total amount of EUR 807 million. In 2000, the Fund's expenditures amounted to EUR 80 million (of which loans represented 26%).
In the course of this period, the following projects received financial support:

- 803 sewage works and drainage systems;
- 120 projects of the reclamation of damage caused by floods;
- 151 contracts on providing support in the form of purchases of drainage equipment;
- 2,365 projects of nationwide gas transmissions into municipalities and gas transmissions, including other fittings, into boiler rooms;
- 905 projects of reductions of the overloading of the nature and landscape, including the waste management.

In the course of the existence of the Fund (since 1992), support aimed at the protection of waters contributed to the reduction of water pollution by 65,066 tons of BSK5 and by 86,015 tons of non-dissolved substances. In the years 1992-2000, the protection of the air succeeded in the total reduction of principal pollutants by 527,416 tons. In 2000, it was reduced by 88,637 tons, which is 46,542 tons more than in 1999.

The fact that the highest percentage of the Fund's previous expenditures was targeted at the protection of the air and water is in accordance with the priorities set by the State Environmental Policy for a short-term period. The character of the projects supported (i.e., the construction of smaller sewage works and of related drainage systems, nationwide gas transmission into municipalities, boiler rooms etc.) corresponds to the needs of both the communal sphere and the Fund's financial possibilities.

Since the Fund launched its activities at the end of 2000, 4,246 positive resolutions have been issued by the minister on providing financial support at the total amount of 878.8 EUR million.

The present set of programs has to face the problem of the permanent prevalence of demands for support over the SFE possibilities: in 2000, for instance, the total sum required through applications was EUR 165.7 million, it means roughly twice as much as the SFE could have met.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
SFE Programs	MOE/ SFE	Protection of the waters.	• Public beneficiary organization and association of municipalities; • Foundations; • Budgetary organizations and contribution organization; • Municipalities; • Association of municipalities; • Civil associations and churches; • NGOs; • Entrepreneurial subjects, housing co-operative and natural persons; • Entrepreneurs; • Inhabitants (natural persons).	• Relative financial costs calculated from costs for measure implementation; • Correspondence with regional policy priorities of environmental protection; • Emergency of environmental protection of the region; • Share of non-returnable and returnable support on total expenses (%); • Quality of technological solution.	Broad set of support tools with different grants and loans depending on type of final beneficiary and sphere of support. Direct financial support: • Grant, • Loan, • combined grant and loan. Indirect financial support: • interest rate subsidy.			Total 80.01
								31.35
		Protection of the air.						34.06
		Program of the care of the environment, protection and usage of natural resources.						5.37
		Garbage handling.						8.31
		Program of the technology and production.						0.28
		Support of selected coalfield districts in Northwest Bohemia.						0.64

Programs for the Support of Renewable Resources of Energy

The state program for the support of energy saving and the use of renewable resources of energy is annually announced by the minister of the environment. This state program represents a collection of targeted subsidiary titles of *investment* character:

- Investment Support of Environment-Friendly Ways of Heating and Potable Water Heating in Apartments, Family Houses and Residential Buildings Designed for Individual Persons;
- Investment Support of Environment-Friendly Ways of Heating and Potable Water Heating in the Communal Sphere;
- Investment Support of Environment-Friendly Ways of Heating and Potable Water Heating in the Non-Profit Sector;
- Investment Support of Heating by Means of Heat Pumps;
- Investment Support of the Construction of Small Hydro Stations;
- Investment Support of the Construction of Wind Stations;
- Investment Support of the Construction of Facilities for Joint Production of Electricity and Heat from Bio-mass;
- Investment Support of Repairs and Reconstruction of Solar Systems in Agriculture;
- The Sun Into Schools program;

and of *non-investment* character (Counseling, Education).

All the above-mentioned items of the given program are funded from the SFE. Recipients of support can recruit both from municipalities and non-profit organizations, both entrepreneurs and individual persons.

All the programs share the same instruments of support; i.e., a subsidy, a loan or the combination of a subsidy and a loan (the proportions of the use of these programs are always set individually according to the character of a particular project and its holder. Entrepreneurial subjects may also receive indirect support, which means the reimbursement of a part of interests from a commercial credit lodged for the funding of the supported project.

All the above-listed items, the programs of the support of renewable resources of energy, either directly or indirectly belong to the **priority axis of the support of investment into infrastructure (P1).** With regard to the EU Principles of Cohesion policy, they also share the same characteristics:

Concentration: the objective of the program is not to reduce inter-regional disparities. From this perspective, the level of concentration is therefore null.

Programming: in order to be eligible to receive support from any of the above-mentioned programs, it is not necessary to include one's intentions in any program document. The level of programming is therefore null.

Partnership: partners in the implementation of support allocated on the basis of respective programs are: a non-profit or entrepreneurial subject applying for support, the SFE, and the MOE CR. They thus rely on the partnership of the public and private sectors.

Additionality: participation in a program is conditioned by co-funding from the side of a supported non-profit or entrepreneurial subject - the principle of additionality is thus fulfilled.

Transparency: all the above-mentioned programs are approved by the MOE CR, which also sets their rules (defining applicant eligibility for support, conditions of support, the period during which the support is provided, the application process etc.). The actual amount of funds is conditioned by the possibilities of the SFE budget, whose autonomous income may be delegated by law (part of fees on pollution), but the main sources of funding to the given programs are occasional transfers of funds from the National Property Fund, approved by the Parliament. This means that SFE possibilities are highly differentiated in individual years and, as a result, applicants´ chances of getting support are uneven. Formally, the selection procedure is completely transparent: the conditions of support are publicly and duly announced, the quality of applications is evaluated by independent councils of experts, the SFE Director's recommendation of the project for support is further confirmed by the Fund Council (composed of independent persons) and the contract on support is signed by the minister of the environment.

This program displays a high-quality concept and attains considerable response from both municipalities and non-profit organizations, and from the private sector. This is further testified by the fact that, in 2000, the SFE registered 121 applications altogether for events and projects linked to the programs of the use of renewable resources of energy (use of bio-mass, solar energy, heat pumps, and further on, the support of investment in construction of small water plants and wind stations). For these applications, the Fund reserved contractual assistance (i.e., subsidies and loans) to the total amount of EUR 9.2 million. Ecological effects are ensured by contracts; i.e., the pollution of the environment will be cleaned at the level of 425.94 tons of solid substances per year and 1,301.24 tons of gaseous substances per year. In connection to this, it should be further stated that within the Sun into Schools program (1,200 W and 100 W photo-volt systems), for which the Fund registered 105 applications in 2000, the requested support in the form of subsidy amounts to EUR 0.34 million.

The only relevant complication is the fact that the given program partly overlaps a similarly conceived program administered by the MIT CR.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
State Program for Support of Energy Savings and Usage for Renewable Resources of Energy	MOE/ SFE	Support of investment projects for usage of renewable energy resources.	• Public beneficiary organization and association of municipalities; • Foundations; • Budgetary organizations and contribution organization; • Municipalities; • Association of municipalities; • Civil associations and churches; • NGOs; • Entrepreneurial subjects, housing co-operative and natural persons; • Natural persons.	• Relative financial costs calculated from costs for measure implementation; • Correspondence with regional policy priorities of environmental protection; • Emergency of environmental protection of the region; • Share of non-returnable and returnable support on total expenses (%); • Quality of technological solution.	• Subsidy; • Loan; • Combination of a subsidy and a loan (entrepreneurial subjects may also receive indirect support, which means the reimbursement of a part of interests from a commercial credit lodged for the funding of the supported project).			9.21

4.2.4 MINISTRY OF AGRICULTURE (MOA)

The Ministry of Agriculture is one of the ministries with the largest volume allocated to different support programs within its responsibility. While a majority of support programs are targeted at provision of assistance to agricultural and forestry firms, since the year 2001 some programs also focus on support to construction of municipal infrastructure, especially water lines, sewage and sewer systems and of water treatment plants. Moreover, some of the support programs aimed at agriculture businesses have a distinct regional dimension. These programs focus on alleviation of effects stemming either from adverse natural conditions for agriculture in some regions, or from the legislative regulations limiting the extent of economic activities in protected areas like the national parks or watershed areas of dams for drinking water. Consequently, the Ministry of Agriculture was the first line ministry (obviously, with the exception of Ministry of Economy which was renamed to Ministry for Regional Development in 1996 and has remained responsible for official regional policy), to explicitly commit itself to regional policy within its sector.

Generally, it should be noted, that the Ministry of Agriculture (MOA) is one of the few Czech ministries that is performing a basic evaluation of the effectiveness and efficiency of its support programs, but also an evaluation of the impacts of agricultural policy on the environment (see Analýza účelnosti a ekonomické efektivnosti podpor zemědělství za rok 2000, Prague, 2001).

From the implementation point of view, the most important subjects of this analysis providing support are the Ministry of Agriculture and Agriculture and Forestry Support and Guarantee Fund (AFSGF). The AFSGF fulfills the role that is similar to the one performed by the Czechomoravian Guarantee and Development Bank in the industrial sector (see section 4.2.1 Ministry of Industry and Trade).

The MOA is directly responsible for implementation of the following support programs targeted at water-related municipal infrastructure (or infrastructure owned by the distribution firms where the municipalities are dominant shareholder): Program for Construction and Reconstruction of Waterlines and Water Treatment Plants, and the Program for Construction and Upgrading of Wastewater Treatment Plants and Sewage. The programs belong to the **priority axis of the support of investment into infrastructure (P1).**

Evaluation According To Principles of the EU Cohesion Policy:

Concentration: No regional dimension is followed but a certain priority is given to projects in environmentally sensitive areas.

Programming: Priority is given to the projects in line with the Program of development of waterlines and sewers or, if this program does not exist, in line with strategic plan of the respective region or district.

Partnership: No partnership is applied in implementation of this program.

Additionality: The state provides grants of up to 65 percent, if the total project costs are lower than EUR 142.9 thousand, and 55 percent if the total costs exceed EUR 142.9 thousand. Thus, the principle of additionality is applied in a level similar to the one in Objective 1 regions.

Transparency: The projects are submitted to regional office of MOA and selected by a committee consisting of representatives of Ministry of Agriculture and of Ministry of Finance.

The Agriculture and Forestry Support and Guarantee Fund (AFSGF) is responsible for implementation of several programs of which the following are relevant for this study:

- *Mládí* (Youth); *Provoz* (Operation); Export and *Investice* (Investment); including three subprograms:
- *Zemědělec* (Farmer);
- *Odbytová Organizace* (Organization Selling Agriculture Products);
- *Hygiena* (Hygiene).

All these support programs aim to improve the economic situation of agricultural firms, to improve of quality of their production, to develop alternative forms of agricultural product use and to enhance the interest of young people in agriculture and forestry sector enterprises.

The programs belong **to the priority axis of the support of enterprise (P2)**.

Evaluation according to principles of the EU Cohesion policy:

Concentration: No regional dimension is followed but a certain priority is given to projects in environmentally sensitive areas.

Programming: Currently, no programming documents are required.

Partnership: No partnership is applied in implementation of this program.

Additionality: The main incentives are provision of bank guarantees and of interest rate subsidies. Therefore, the full cost of the project has to be covered by the final beneficiary (i.e., the firm).

Transparency: Several years ago, a controversy arose about the question whether the list of farmers supported by different support programs should be made public or concealed according to the Act on Protection of Data on Individuals. In 1998, the list was given to the media but the system of provision of grants has not been challenged.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
AFSGF Grants	AFSGF	Support to non-productive function of agriculture	Wide range of grants specified by the Czech Government resolution 344/1999 and by law 252/1997: • support of activities helping to preserve nature • programs of support of less favorable areas for agriculture					105.12
Investice/ Investment Support Program To Perspective Businesses Focused on Long-Term Investment Projects Aiming At Restructuralization and Increased Efficiency of Enterprises in Agriculture and in Food Industry	AFSGF	*Zemědělec*/Farmer-Support of perspective enterprise subjects in agriculture	• Natural person or a firm • Individually enterprising farmer • University • Agriculture or forest farm • Municipality that owns forest land	• Performing agricultural or forestry activities or activities in water management	• Support is provided in the form of interest subsidy • Support is provided in the form of bank guarantees (up to 60%)			28.12
	AFSGF	*Odbytová Organizace*/ Organization Selling Agriculture Products-Development of organizations selling agricultural production	• Natural person or a firm	• Selling agricultural production	• Support is provided in the form of interest subsidy • Support is provided in the form of bank guarantees (up to 60%)			
	AFSGF	*Hygiena*/ Hygiene-Health safety of food	• Firms in food industry.					not launched in 2000
Export Program for Support of Export of Selected Agricultural and Food Industry Products	AFSGF	Export- Support to export of selected agricultural commodities.	• Natural person or a firm; • Individually enterprising farmer; • University agriculture or forest farm; • Municipality that owns forestland.	• Performing agricultural or forestry activities or activities in water management; processing of agricultural products; sale of agricultural products; • Respecting the list of eligible commodities.	• Support is provided in the form of interest subsidy.			0.6

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Mládí/ Youth Support Program for Young Farmers	AFSGF	*Mládí*/ Youth- Support for start-ups and development of family firms run by young farmers up to 35 years.	• Natural person or a firm; • Individually enterprising farmer.	• Performing agricultural or forestry activities or activities in water management; processing of agricultural products; sale of agricultural products; • Younger than 35 years; • Should participate in program *Provoz* and/or *Investice* and guarantee 10 years of commitment to these activities.	• Support is provided in the form of interest subsidy for loans provided by programs *Provoz* or *Investice-Zemědělec* • Support is provided in the form of bank guarantees: in case of co-eligibility for both program *Mládí* and *Provoz* up to 50% , in the case of co-eligibility of programs *Mládí* and *Investice- Zemědělec* up to 60%.			
Provoz / Operation Short Term Support Program for Solving Seasonal Swings in Financing of Operational Costs	AFSGF	Help to solve temporary lack of own financial resources for operational costs.	• Natural or legal person; • Farmer.	• Support of activities in the field of agriculture or forestry or activities in the field of water management; processing of agricultural production, sale of agricultural commodities.	• Grant for payment of part of the loan interest, which does not exceed 12 months (exceptionally 18 months). • Guarantee for bank loan up to 30%.			
Construction and Reconstruction of Waterlines and Water Treatment Plants	MOA	1. Construction of waterlines and other water works objects. 2. Construction and reconstruction of equipment used for preparation of drinking water. 3. Replacement of asbestos waterlines by other materials.	• Municipalities; • Municipal associations; • Water management firms with at least 2/3 majority share of municipalities.		• Matching special grant of 65% in case of eligible cost of project is up to EUR 142.9 thousand, and 55% in case the project cost is over EUR 142.9 thousand and interest rate subsidy up to 75% of interest payments. • Max. 80% of total investment costs.		28.14	

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Construction and Upgrading of Waste Water Treatment Plants and Sewage	MOA	Construction, extension and upgrading of waste water treatment plants in municipalities with more than 3 thousand inhabitants, construction and extension of sewerage systems	• Municipalities; • Municipal associations; • Water management firms with at least 2/3 majority share of municipalities.		• Matching special grant of 65% in case of eligible cost of project is up to EUR 142.9 thousand, and 55% in case the project cost is over EUR 142.9 thousand and interest rate subsidy up to 75% of interest payments. • Max. 80% of total investment costs.		11.74	

4.2.5 MINISTRY OF LABOR AND SOCIAL AFFAIRS

The Ministry of Labor and Social Affairs (MOLSA) is responsible for an active labor market policy with important regional dimension. According to National Development Plan of the Czech Republic (2001), the active labor market policy is based upon a relatively broad range of programs that include the support to the employment of vulnerable groups, re-training and support for the creation of job opportunities. In comparison to the EU countries, where the share of expenditures for the active employment policy amounts to 3 percent of the GDP, the amount of these funds in the CR, forming approximately 0.1 percent of the GDP[16], is relatively low. The envisaged development of the labor market requires expansion of the range of programs of the active employment policy with emphasis on preventive measures, that will besides others, enable the groups of persons that have so far been excluded, to participate in the programs.
The programs belong to the **priority axis of the development of human resources (P3).**

Evaluation according to principles of the EU cohesion policy:

Concentration: The volume of funds allocated to particular job centers in the districts depends on the situation of the labor market in respective regions, namely, on the rate of unemployment and on the vacancy/unemployment relation. Thus, the regions with highest unemployment rate are supported more vigorously via labor market policy than less-affected regions. Moreover, two regions with the highest unemployment rate (i.e., Northwest Bohemia and Ostrava regions) are a specific priority of this policy.

Programming: The active employment policy is implemented according to priorities of state employment policy via the detailed Program of Implementation of Active Employment policy for each respective year, and according to the National Employment Plan, which is in turn, in line with the European Employment Strategy.

Partnership: No partnership is officially applied in the implementation of this program, but district Labor offices are inevitably in close contact with major employers and other relevant subjects.

Additionality: In the majority of support schemes, additionality is required since grants are provided in the form of a contribution toward covering total costs. In certain cases, esp. in the case of wage subsidies, the full wage can be provided including health and social security payments.

Transparency: The supported projects are selected by respective regional (district) Labor Offices.

In 2000, EUR 97.8 million was used for the Active Employment Policy (AEP), while EUR 162.9 million was devoted to the passive employment policy (provision of social benefits). Thus, the share of AEP in total expenditures of the state employment policy has increased to 37.5 percent (from 25.2 percent in 1999). The significant shift towards AEP is to be assessed positively. In 2000, 27,240 new jobs were created, as well as 19,714 workplaces in public works, and 11,478 workplaces for graduates and the young. The number of retrained persons reached 33,300. Moreover, 1,434 jobs for handicapped persons were created.

In addition to the active labor market policy, the MOLSA is also responsible for the Pro-Active Labor Market Intervention Fund (PALMIF), though it is implemented by the independent organization, the National Training Fund (NTF). PALMIF projects are supported by the PHARE program. The volume of the funds allocated to human resource development in the years 1992 – 2000 amounted to EUR 30 million in total. Due to the relatively restricted funds, the PHARE program could not radically influence the situation on the labor market. However, it is important that it helped to establish the institutional structures, the relations between them, and that it

[16] Data for 1999, MOLSA

significantly contributed to the transfer of know-how. The existing implementation mechanism and experience gained by the central and regional participants during the realization of these programs represent a considerable comparative advantage for the preparation and implementation of the human resources development section within the framework of PHARE, (Economic and Social Cohesion section).

Evaluation according to principles of the EU cohesion policy:

Concentration: The intention of the PALMIF was to implement at least one pilot project according to the EU methodology in as many districts as possible, in order to provide hands on experience needed for future support from the Structural Funds. Therefore, from the concentration principle, the primary aim was to achieve balanced regional coverage by project selection.

Programming: the projects supported by PALMIF were selected according to their coherence with measures and priorities of the state employment policy.

Partnership: Compliance with the EU principle of partnership is a condition for considering the grant application for PALMIF support. In addition, since 1998, the projects are supervised on a decentralized basis in the regions, to move the procedures closer to those of ESF. Also, the principle of partnership of governmental and non-governmental bodies, in evaluation and selection of the projects, was applied (i.e., respective Labor Office, PALMIF Support Unit and PALMIF Steering Committee). Moreover, a priority was given to projects where the ability of the partner organizations to further develop their cooperation was secured.

Additionality: The ability to co-finance the project from national resources was a precondition for granting PHARE support.

Transparency: The supported projects are selected by the respective region (district) in cooperation with PALMIF Support Unit and PALMIF Steering Committee, whose membership respects the principle of partnership.

In total, between 1991 and 2000, 173 projects were supported within PALMIF scheme. The number of newly created jobs amounted to 2,440, and the number of persons that graduated in various re-training courses was 14,734.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Active Labor Market Policy	MOLSA	Solution to the unemployment problem (indirect business support).		Tools of active labor market policy are not aimed at direct business support but their application positively affects development or stabilization of enterprises in the regions. Support is provided in the form of grants or loans. The support is provided by local job centers.	• Support of retraining of job seekers; • Support of new public job opportunities; • Practical training of school leavers and the young people; • Protected workshops for handicapped; • Investments incentives		97.77	
PALMIF (Pro-Active Labor Market Intervention Fund)	MOLSA/ NTF	Support of active measures on labor market in individual regions.	Subject of public or private sector.	Priorities proposed by MOLSA are related to measures of the State Active Labor Market Policy and targets specified by regional and local labor markets.	• Regional level projects min grant EUR 20 thousand, max. EUR 50 thousand • National level projects max. EUR 150 thousand	1.2	0.3	
Program for Development of Social Services	MOLSA	Projects in the fields of social service, social intervention, drugs prevention policy and crime prevention.	Non-governmental non-profit organization natural persons.		• State grants up to 70% of total project costs		9.77	

4.2.6 MINISTRY OF CULTURE

The Ministry of Culture, as a central public institution, is providing finances to contributory organizations (theatres, art companies, libraries, museums, and galleries) and for grants in the amount of EUR 71.4 million per year (year 2000). As a comparison, EUR 200 million were given for culture from budgets of municipalities and district offices.

Usually the financial contribution connected with preservation and renovation of cultural heritage is given to the owner by the district office on the basis of his/her request. Municipal co-financing is gradually growing, especially in cases of renovations with the state co-financing. In the case of a project of special public interest to preserve cultural heritage, the Ministry of Culture can grant financial support through the following Cultural Conservation Programs:

1. Rescue fund (*roof program*).
2. Regeneration of city preserves and city preserve zones program.
3. Preservation of architectural heritage program.
4. Maintenance of village preserves and zones and landscape preserve zones.
5. Program for restoration of chattel cultural heritage.

In all programs prepared by the Ministry of Culture, the principle of additionally is complied with,. especially in cultural conservation programs, where multi-fund financing is usual. The private and public (municipal, district) sources are used as a complement to state finances. In the last five years, the state contribution from the state budget for cultural conservation programs was, on average, approximately 50 percent.

Evaluation according to principles of the EU cohesion policy:

Concentration: A.) No regional dimension is followed in programs 1, 3, 5. B.) Resources are being distributed only to cities and villages with declared preservation (40+1) or preservation zone (209) in program 2, in program 4 into hundreds of declared areas mainly villages.

Programming: Programs are based on implementation of the Strategy of More Effective State Support To Culture and have at least five years tradition.

Partnership: No partnership is applied in implementation of this program.

Additionality: multi-fund financing is already the norm, using private resources (owners of cultural monuments) and public resources (municipalities, districts) that complement grants from state budget. Total co-financing from the state budget reached approximately 50 percent over the last five years.

Transparency: For program 1, the projects are submitted to evaluation committees at each Regional Conservation Authority, and subsequently the Ministry of Culture decides on actual distribution of finances. For programs 2, 4, 5 an overview of application for support is done at district level, and is approved by District Office and is sent to the Ministry of Culture. Consecutively, the Ministry of Culture decides on distribution of finances.

The projects within program 3 are submitted to the Ministry of Culture, which decides about granting the support. The Committee for Preservation of Architectural Heritage Program, nominated by the minister of culture, gives a review of projects.

Grants in the Field of Information Dissemination and Art Development

The Ministry of Culture announces a number of programs each year that shall support a wide range of non-commercial infrastructure or artistic projects. For implementation of projects, co-financing by the applicant is necessary, usually in the amount of 50 percent. Other EU principles are minimally taken into account. Programs have the character of grants and are decided on at the level of the Ministry of Culture.

Programs:

- Public information library services
- Library of the 21st century
- Grants in the field of literature and book culture
- Program of cultural activity (grants in the field of professional art, architecture, design, applied art and craftsmanship; grants to support public beneficial projects in the field of professional theatre art; grants to support public beneficial projects in the field of professional music art)
- Czech theatres support program (support program for symphonic orchestra; support program for support of permanent professional symphonic orchestra and choir)
- Grants for museums, galleries, memorials for projects from the field of preservation and presentation of movable cultural heritage of Czech republic regions.

Evaluation according to principles of the EU cohesion policy

Concentration: No regional dimension is followed in these programs.

Programming: Programs are based on implementation of the Strategy of More Effective State Culture Support and started, in the majority of cases, in 2000.

Partnership: No partnership is applied in implementation of this program.

Additionality: The state budget contribution is 50-70 percent, in the case of loss, it is 100 percent for that loss.

Transparency: The projects are submitted to a professional evaluation committee or department of the Ministry of Culture and decisions about support are published in the form of a Ministerial decision.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)			Eligible Regions
						EU	SB	Off-BF	
Program of Preservation and Renewal of Cultural Heritage	MOC	Crash-roof program	• Owner of the landmark/ monument.	• Secure urgent reconstruction architectural heritage	• Grants about 50% of the eligible expenditure (on average)		0.92		
		Regeneration of city preserves and city preserve zones program		• Support and development of historical cities			7.05		Cities and municipalities with preserves and preserve zones program
		Preservation of architectonic heritage program		• Preservation of the culture heritage			7.22		
		Maintenance of village preserves and zones and landscape preserve zones		• Reconstruction and maintenance of the folk culture heritage			0.43		Village preserves and zones and landscape preserve zones
		Program for restoration of chattel cultural heritage		• Maintenance, restoration, appropriate usage and marketing of the chattel cultural heritage			0.43		
		Public information library services			• Grants up to 70%		39.6		
		Library of the 21st century			• Grants up to 50% of non-investment expenditure				
		Program of cultural activity		• Grants in the field of professional art, architecture, design, applied art and craftsmanship • Grants to support public beneficial projects in the field of professional theatre art	• Grants up to 50% of the project expenditure		7.39		
		Czech theatres support program	• Organizations established by state bodies or self-governments.	• Support program for symphonic orchestra • Support program for support of permanent professional symphonic orchestra and choir			1.43		

4.2.7 STATE FUND FOR TRANSPORT INFRASTRUCTURE (SFTI)

Maintenance of roads is a basic state responsibility. Their development is closely connected with economical development, an increase of living standard, and determines development of activities that take place in the area.

Until the year 2000 (the date of establishment of State Fund for Transport Infrastructure), maintenance, reconstruction and investment in the transportation network were mainly financed from state budget from a chapter of the Ministry of Transport and Communications. The disadvantage of state budget financing was dependence on the yearly cycle of the state budget.

The main tool for investment and common expenditures in transportation infrastructure is the State Fund for Transportation Infrastructure. SFTI was established to finance construction, maintenance and modernization of roads, highways, transport railways and inland waterways. SFTI launched its activity in September 2000. The main resources for SFTI are transfers from National Property Fund and taxes (road tax, charges for usage of selected roads and highways).

The programs belong to the **priority axis of the support of investment into infrastructure (P1)**.

A total of EUR 243.3 million were distributed from SFTI in 2000. Basic areas that were financed from SFTI are:

- Construction, modernization and maintenance of roads and highways;
- Grants for construction and modernization sections of national roads and highways on municipal territories;
- Construction, modernization, reconstruction and maintenance of nationwide and regional railways;
- Construction and modernization of important inland waterways;
- Grants for construction and maintenance of bike trails.

Total investment from SFTI reached about EUR 142.9 million, from that approximately EUR 94.3 million (65.1 percent) went into roads and highways and EUR 45.7 million (31.5 percent) went into railroads. Non-investment expenditures were about EUR 100 million.

The finances from SFTI were released on the basis of contracts concluded with beneficiaries. The responsibility for usage of given finances is with SFTI. On-spot-check visits at subcontractors are included in contracts with beneficiaries. Annually, the SFDI financial report was audited and was approved without comment.

Evaluation according to principles of the EU cohesion policy:

Concentration: Limited principle of concentration is followed. The priority in the transportation sector is on building roads of European importance (TENs), on the gradual completion of network of highways and high-speed roads in the main transportation directions including construction of a beltway around Prague. The same principle applies to construction of railway corridors, where the priority is modernization of main railways of European importance.

Programming: The basic programming document is the Transport Policy of the Czech Republic, approved by the government in 1998. It is a strategic document for the CR and an important component of pre-accession strategy for EU accession. Single tasks, that result from transportation policy were further specified in the Mid-Term Strategy of Transport, Telecommunication and Mail Development Till 2010, which was further specified in Development of Transport Network in the Czech Republic Till 2010, prepared in 2001.

Partnership: The principle of subsidiarity is implemented in Transportation Policy in the Czech Republic. Highways and national roads are maintained by the state. Regional councils maintain secondary roads. Tertiary and fourth class roads are in the competency of municipalities.

Additionality: Additionality is specific in the field of transportation policy because the modernization and construction is financed from the level, which has the competency for the respective roads. The state may co-finance projects through SFTI communications that are in competency of the regional councils and municipalities in the cases of national or supra-regional importance.

Transparency: The specific characteristics of transportation construction are out of the scope of projects as well as high expenses for project implementation. Transparency is assured by a public procurement law.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
State Fund for Transport Infrastructure (SFTI)	SFTI	Development, construction, maintenance and modernization of roads, highways, transport railways and inland waterways.	Owners of relevant infrastructure.	Construction and modernization of reconstruction and maintenance of roads and highways.	Investment grants			178.25
				Grants for construction and modernization sections of national roads and highways on municipal territories.				2.26
				Construction, modernization, reconstruction and maintenance of nationwide and regional railways.				57.81
				Construction and modernization of important inland waterways.				4.87
				Grants for construction and maintenance of bike trail.				0.13

5. Pre-Accession Support Programs

5.1 PHARE PROGRAMS IN THE SPHERE OF POLICY OF ECONOMIC AND SOCIAL COHESION

PHARE Cross-Border Cooperation Programs

Cross-border cooperation programs (the PHARE CBC program) were the most significant form of EU support for regional development in the Czech Republic in the years 1994 to 1999. Responsibility for implementation of the PHARE program rests with the Ministry for Regional Development.

The cross-border cooperation program has been implemented on the basis of European Commission regulation No. 1528/94. The program only began in 1994 for the Czech-German border area. Since 1995, the program has also been implemented in the Czech-Austrian border area, on the basis of the Multi-Annual Indicative Program for 1995 – 1999. In 1999, cross-border cooperation was extended to the borders with Poland and Slovakia, pursuant to the Decree of the European Commission No. 2760/1998 on the Implementation of Cross-Border Cooperation within the PHARE program.

During 1994-1999, EUR 125 million was released for projects on the German border. For the Czech-Austrian border, it was EUR 30 million (1995). Further funding was spent on implementing trilateral programs in the Czech-Polish-German and Czech-Austrian-Slovak border areas (EUR 2 million p.a.).

The average total annual volume of funding from the EU exceeded EUR 34.3 million, while the volume of projects supported was EUR 48.6 billion.

In 2000, the Joint Programming Documents for the Czech-German, Czech-Polish and Czech-Austrian border regions were prepared for the Programming Period 2000-2006. The requirement for their preparation arises from EC Decree No. 2760/1998, and from the Opinion of the EC for the INTERREG III Program dated April 28, 2000, which include joint strategies for development of the specified area for both programs and the priority areas of interest.

The PHARE CBC program has been coordinated with a similar EU program (INTERREG II). The common aim is maximum harmonization of the two programs. Joint Program Monitoring Committees have been set up for this purpose. These committees approve individual projects and monitor the program. The Czech side is represented on the committees by representatives of ministries (chiefly the Ministry for Regional Development – co-chairing the committees with their partner ministries), and regions (joint organizational structures function in the regions on the basis of Euroregions).

Greater interconnection between the PHARE CBC program and the INTERREG II program were limited by the different regulations for both programs. Unfortunately, it did not prove possible to harmonize the regulations for the two programs fully for the 2000 – 2006 period. Conditions for the interconnection of the two programs were created by preparing Joint Programming Documents, which assume that the preparation of the program will be executed jointly and after the program is approved, it will be executed separately due to different procedures for both programs.

Pilot Programs of the Structural Funds Type

In 1997, the Ministry for Regional Development selected and approved three regions, representing the main types of regions in the Czech Republic, in which development programs based on the EU Structural Funds would be prepared and implemented:

- An area with structural problems – the Most, Chomutov and Teplice districts (in 1998 this was extended to the whole Northwest NUTS II region).
- A less developed rural area – the Jeseník, Bruntál and Šumperk districts.
- An area with growth potential – the Olomouc, Prostějov and Přerov districts.

The main purpose of the programs is to provide the ministries and the local and regional participants with practical experience in preparing and implementing Structural Funds type programs. This experience will be utilized in implementing the future national program of economic and social development for 2000 – 2006. The main content of these programs in the first phase (1997 – 1998) was staff training, setting up institutional structures far the future implementation of projects, and preparation of projects. Implementation of projects began in the second half of 1999. This selection was extended to the following whole NUTS II regions in the first phase of work on the NDP:

- the Northwest,
- the Ostrava region,
- Central Moravia.

This was acknowledged by the Czech government in resolution No. 714 of July 14, 1999.

PHARE 2000

The European Commission has recommended the concept of "one target region – one program" for investments in the field of economic and social cohesion; i.e., that one program should be drawn up jointly by all the ministries involved for each target region, and that the original projects of three separated ministries should be merged into one. It was decided, that support for economic and social cohesion would be directed into two investment projects in two target NUTS II regions, the Northwest and Ostrava. This would allow the implementation of selected measures from the Competitiveness and Human Resources Development pilot SOPs and from the relevant pilot ROP. The support would also be directed into one project aimed at establishing institutions (the continuation of twinning), the "consolidation of the national development strategy and support including preparation of the employment / human resource development sectors and industry / the productive sector for the acceptance of support from the Structural Funds and cohesion fund". The PHARE 2000 program also supports the "Public Order Awarding System" project, implemented in the form of twinning, which is closely connected with economic and social cohesion.

The documents were completed on an ongoing basis in the light of comments from the Center for Foreign Assistance and the Delegation of the European Commission, and were submitted to Brussels in May via the Center for Foreign Assistance. On June 22, 2000, the PHARE Management Committee approved the Financial Proposal of the PHARE 2000 National Program for the Czech Republic, and on October 31, 2000, a Financing Memorandum was signed for the PHARE 2000 National Program. Within this program, the institution-building project will receive EUR 1.5 million of support. EUR 0.9 million will go to the public orders project, and each of the two target regions will receive EUR 8 million for the implementation of investment projects, and the same amount of funding from the state budget as co-financing of the program (i.e., a total of EUR 16 million).

PHARE 2000 Investment Support Projects

Four projects were selected from the existing target regions for support from the PHARE reserve; two of these were located in the Northwest NUTS II region and two in the Ostrava NUTS II region:

- Cheb industry park
- Lovosice transport / goods center
- Ostrava-Mošnov industrial zone
- Kopřivnice-Vlčovice industrial zone

Institution-Building Projects

On the basis of negotiations, it was decided that ministries would draw up programming documentation for the following projects to establish institutions: Completion of Institutional Structures and Measures to Increase Absorption Capacity at National and Regional Level under the Ministry for Regional Development. (This project is aimed primarily at training, where the target groups are largely regional and sectorial actors at NUTS II level). Within the competences of the MIT, the projects include the Strategy for Regeneration and Use of Existing Industrial Premises and Buildings, and the Strategy for Industrial Zones. The projects aim at mapping and preparing, with comprehensive methodology, the system of use of existing industrial premises, especially for potential industrial investors, such as potential industrial parks, incubators or *Innovation Centers*. From the point of view of regional priorities, the projects are aimed at the North Moravia region, which serves as the pilot region for other areas of the Czech Republic.

5.2 SAPARD

The SAPARD program is based on Council Regulation EC 1268/2000 on Communities support for pre-Accession measures for agriculture and rural development in candidate countries in the pre-Accession period.

The objective of the program is to create a Community Support Framework for sustainable agriculture and sustainable rural development in the pre-Accession period for candidate countries, particularly with regard to the following aspects:

- Introducing corresponding rules and approaches relating to the common agricultural policy and similar concepts,
- dealing with priorities and local problems of the permanent adaptation of the agricultural sector and rural areas in candidate countries

The priorities of the SAPARD program were set in the Agricultural and Rural Development Plan for 2000 – 2006, which was discussed by the Czech government in July 2000 (resolution No. 769/2000). The priorities of the SAPARD Plan focus on introducing the *acquis communautaire*, and maintaining the competitiveness of companies in agriculture and the food industry, and on sustainable economic and social development and stability of rural areas through improvements in the environment and living conditions and revitalization of business.

On September 13, 2000, the European Commission advisory committee for agricultural structures and rural development (STAR) approved the SAPARD Plan for rural and agricultural development in the Czech Republic. This was confirmed by European Commission Decision No. C (2000) 3105final of October 26, 2000. The final version of the SAPARD Plan was submitted to the government and acknowledged on March 7, 2001. On February 2, 2001, the Multi-annual

Agreement with the EC Commission was signed and on its basis, the Ministry of Agriculture applied for the launch of the process of accreditation of the SAPARD agency. Only after the completion of the process, may the Commission grant consent to the start of implementation of the SAPARD program. In March 2002, the mission of EU auditors to the SAPARD Paying Agency was successful, and consequently, the EU consent to launch SAPARD in the Czech Republic is expected shortly. One of the reasons for such delay in launching the implementation of SAPARD is the fact that the Czech Republic asked for accreditation of a relatively high number of measures. The support measures are:

- Welfare of livestock;
- Reconstruction of storage capacities for fruits and vegetables;
- Storages for products from livestock;
- Modernization of technologies;
- Support of regional products (marketing);
- Improvement of structures for quality control of food and protection of consumers;
- Melioration and land adjustments;
- Development of municipal infrastructure;
- Diversification of production and alternative activities;
- Improvement of qualification;
- Technical assistance.

The responsibility for SAPARD is shared by the Ministry for Agriculture and by the Ministry for Regional Development. The Ministry of Agriculture is responsible for the Paying Agency of SAPARD, and for communication with subjects operating in the agriculture sector, while the Ministry for Regional Development is responsible for the rural development component of SAPARD, and for communication with municipalities. While measures related to agriculture will be applied horizontally, rural development measures will be implemented in voluntarily-formed rural micro-regions with populations between 3-30 thousand. These micro-regions are based on geographical, historical and other factors, but do not correspond to any region in the NUTS hierarchy.

5.3 ISPA

The objective of the ISPA program is to contribute to candidate countries' preparations regarding economic and social cohesion with emphasis on the environment and transportation sectors.

Support for the Czech Republic concerning the environment concentrates on safeguarding the quality and quantity of water. This primarily involves reconstruction and improvement of existing sewage treatment plants in communities of over 2000 inhabitants.

Support regarding transport contributes to the development of an efficient transport system.

In October and November 2000, five projects from the ISPA 2000 budget were approved for the Czech Republic by the European Commission. For each project a Financing Memorandum (FM) was signed on February 7, 2001, stating this information.

- Transport – the total allocation from ISPA 2000 is EUR 41,671,864.
- Project 2000 CZ 16 P PT 003 – Section of R48 Expressway Frýdek-Místek–Dobrá – total cost of project: EUR 36,341,990, total ISPA grant: EUR 20,391,677, of which, the 2000 allocation: EUR 10,051,734;
- Project 2000 CZ 16 P PT 006 – Railway Section Záboří–Přelouč – total cost of project: EUR 65 560,339, total ISPA grant: EUR 30,907,420, of which, the 2000 allocation: EUR 20,408,066;

- Project 2000 CZ 16 P PT 002 – Railway Section Ústí nad Orlicí–Česká Třebová – total cost of project: EUR 30 485,160, total ISPA grant: EUR 14,300,080, of which the 2000 allocation: EUR 11,212,064.
- Environment – the total allocation from ISPA 2000 is EUR 34 486,055.
- Project 2000 CZ 16 P PE 001 – Extension of Sewage System in the City of Ostrava – total cost of project: EUR 40,720,168, total ISPA grant: EUR 16,644,682 of which, the 2000 allocation: EUR 13,315,746.
- Project 2000 CZ 16 P PE 002 – Sewer System of the City of Brno – total cost of project: EUR 39,273,300, total ISPA grant: EUR 17,841,373, of which, the 2000 allocation: EUR 14273,068.

All these amounts are commitments from the EU budget. Actual payments will be made according to the basic rules, that 10 percent of the ISPA grant will be transferred to the Czech Republic when the FM is signed, another 10 percent when the contract is signed, and the remainder (up to 80 percent) will be paid according to invoices which will be submitted.

Another set of projects has been approved in 2001. In July 2001, ISPA Managing committee approved project „Road bypass of Bělotín“. Total investment costs amount to EUR 28.5 million (contribution from ISPA equals EUR 17.1 million). The second approved project is a system for water supply and wastewater management and treatment in the North Bohemia coal basin (ISPA contribution EUR 12.87 million).

In November 2001, two more transportation projects were approved. The first in upgrading of the road Dobrá – Tošanovice (R48) (ISPA contribution is EUR 19.8 million). This project is a follow up of project from year 2000 (Frýdek-Místek - Dobrá).

In the sphere of the Environment the following projects were approved:

- Intensification and Reconstruction of Wastewater Treatment Plant and Sewage System in Jihlava Region (ISPA EUR 9.62 million, which covers 65 percent of total eligible costs). Beneficiary is association of 35 municipalities in Jihlava.
- Completion and Reconstruction of Sewerage System in Olomouc – contribution from ISPA covers 70 percent of total eligible costs (10.1 million €).

In the case of an ISPA project, the stress is clearly put on large-scale projects with easily measurable benefits. This emphasis thus contributes to development of inter-municipal cooperation.

Name of Program	Responsible Authority	Objective of Program	Final Beneficiary	Program Conditions	Incentives	Financial Resources (EUR Million)		
						EU	SB	Off-BF
Instrument for Structural Policies for Pre-accession (ISPA)	MRD/ MOE and Ministry of Transport	Financial support for investment in the areas of environment and transport.	Czech Railways, Directorate of Motorways and Cities, municipalities.	High quality and of a sufficient scale pre-identified measures defined as "projects", "stages of a project", "groups of projects" or "project schemes" with a significant impact in the field of environmental protection or the improvement of transport networks.	• Investment grants up to 75 % of public or equivalent expenditure (In some cases, the rate of assistance can be increased up to 85 %, in particular where the Commission considers that a higher rate is required for realizing projects central to the general objectives of ISPA.) • Rate of assistance shall be modified from the maximum rate mentioned above, taking into account: • Availability of co-financing; • Capacity of the project to generate revenues; • Application of the polluter-pays principle.	57.2-83.2	Environment – Municipalities	Transport – State Fund for Transport Infrastructure; Environment – State Environmental Fund

Table 9. Summary of the Structure of Support Programs According To Priority Axes of the EU Cohesion Policy

Sphere	Programs	Financial Resources (EUR million)		
		EU	SB	Off-BF
Infrastructure (P1)	Program of the Support of Industrial Zones		11.24	
	MRD Regional Support Programs I.		9.75	
	Program of Revitalization of Countryside		16.19	
	CBC/PHARE Large Infrastructure Projects	17.1		
	Grants for Tourist Regions		0.62	
	Programs of the Support of Housing		132.12	21.59
	Programs of the Protection of the Components of the Environment			80.01
	Programs of the Support of Renewable Resources of Energy			9.21
	Programs Construction and Reconstruction of Water Related Infrastructure		39.88	
	State Fund for Transport Infrastructure			243.32
	Subtotal	17.1	209.8	354.13
				581.03
Business Promotion (P2)	MIT Programs of the Support of SMEs	3.31	88.04	
	MIT Regional Business Support Programs (START and RECONSTRUCTION)		3.9	
	Programs of the Support of Research and Development (Technos and Park)		6.34	
	Program of the support of energy saving and of the use of renewable resources		6.3	
	Programs of the Support of Risk Capital (Fund for Risk Capital and Czech Venture Partners)	4.89		
	EU Programs for SMEs (Euro Info Correspondence Centers, Europartenariat, Interprise)	0.09	0.16	
	Programs of the Support of Participation in Trade Fairs and Expositions and of the Support of Propagation Activities		4.7	
	MRD Programs of the Regional Support SMEs		10.93	
	MRD Regional Policy Programs II. (RegioGuarantee, Region 2, Regional Support Programs for Industrial Enterprises in Northwest Bohemia and Ostrava regions)		17.36	
	SMEs Support Programs in the Sphere of Agriculture			28.72
	Subtotal	8.29	137.73	28.72
				174.74
Human Resource Development (P3)	Programs of the Support of Research and Development (EXPORT, CENTERS, STRATECH)		32.68	
	CBC/PHARE Small Projects Fund	1.9		
	Active Employment Policy		97.77	
	PALMIF	1.2	0.3	
	Program for Development of Social Services		9.77	
	Subtotal	3.1	140.52	
			143.62	
Total		28.49	488.05	382.85
				899.39

Note: Programs of Ministry of Culture were not included in the tables because of their specific character.
Pre-structural instruments were not included in the tables because of their beginning after 2000.

Programs of support to non-productive function of agriculture were not included.

6. Conclusions and Policy Implications

The extensive set of support programs, that are implemented by the central bodies of state administration to subjects from both the public and private sector, covers all three priority axes of the EU cohesion policy relatively evenly; i.e., first development of infrastructure and investment into the environment, second human resource development and third business support. Therefore, from this point of view, the set of support programs is elaborated and balanced. In total, the volume of financial resources is massive and amounts to several dozens of billions of CZK (billions of EUR.).

Despite the elaborate nature of support programs and sizeable amount of financial resources, the package of support programs suffers from several serious weaknesses, which reduce their effectiveness and efficiency significantly. In the case of municipalities, the basic weakness is the unprecedented instability of the system of their financing. Frequent and radical reforms of the system of local government financing (and therefore, also significantly reduced predictability of revenues in the future) limit the possibilities of municipalities to participate in different support programs. In consequence, participation in state support programs that, as a rule, require co-financing from municipalities, becomes a relatively risky venture. This causes, on the one hand, lower interest of municipalities in submitting project proposals, and on the other hand, contributes to the growth of municipal debt (A sizeable proportion of municipal debt represents financial obligations connected with drawing resources from state support programs!). This weakness is further multiplied by the fact, that a majority of municipal projects are implemented from the resources provided by the state budget operating on annual basis. Consequently, these resources have to be allocated, committed and administered into the accounting system within a given year. The financing from the funds operating on multi-annual basis is rather an exception.

As far as support programs for entrepreneurs are concerned, the principal weaknesses are the insufficient effect of these programs and cumbersome administrative procedure. Both these weaknesses are closely connected with the fundamental shortcoming of support programs in general, which is their enormous fragmentation. In the Czech Republic, public support is provided via several hundred programs and subprograms which, as a rule, suffer from an insufficient amount of financial resources, and which require meeting specific criteria that are different for individual programs.

Excessive fragmentation of support programs, thus significantly increases the administrative costs of implementation of these programs, especially the elaboration of projects, evaluation, selection and contracting, but also the accumulating costs of financial and physical controls. The high cost of administration squeezes, not only expenditures on promotion of support programs among potential beneficiaries, but even the amount of resources allocated to supported projects themselves. Another negative aspect caused by extreme fragmentation is the complexity and unclear nature of the whole system of support programs. This hinders access to these programs particularly to small and medium size enterprises (SMEs). For these firms, it is difficult not only to find out what kind of support programs are on offer, but notably, to acquire a specific knowledge needed for project application and implementation according to particular support scheme.

Another systemic weakness of support programs related to their huge fragmentation is their very limited mutual consistency, especially as far as mitigation of regional disparities is concerned. Consequently, financial resources allocated to one support program artificially stimulate demand for support from other support schemes. For example, a grant to housing construction is frequently allocated to affected regions with limited job opportunities as “annex” to other support programs. Another important example of inconsistency of support programs is the very limited coherence among national support schemes and EU support programs.

A key source of problems with coordination of different support programs that is almost completely missing is the application of the principle of programming for evaluation of social and economic relevance, and effectiveness of support schemes. In the same vein, the support programs are only exceptionally tied up with corresponding sectorial strategies. The condition of a proposed project to be included in local or regional development strategy is, in fact, only applied in a single support program financed by the Czech financial sources; i.e., in the Program of Revitalization of Countryside. However, it should be stressed, that over the last two years, a significant improvement in this sphere has been recorded, and as a rule, relevant sectors are approving strategic programming documents, though even now (year 2002), the situation is far from ideal. Frequent weaknesses of programming documents are their limited mutual consistency and overlapping, sometimes a formal approach towards their drafting and limited invention.

Several controversies related to programming documents also stem from a necessity to adhere gradually towards the rules and mechanisms of the EU cohesion policy. Firstly, according to the European Commission, the whole territory of the Czech Republic represents one problem region, which is almost internally undifferentiated(with the exception of Prague). Consequently, the narrowing of the gap separating the Czech Republic from the EU average is considered a principal problem. This fattening view was developed mostly due to rigid application of the standard indicator used for delineation of EU Objective 1 regions (less than 75 percent of the EU average GDP/per capita in PPS over the last three available years). In the Czech Republic, the regional GDP is still calculated by an imprecise *from the top* method (i.e., by the transposition of sectorial contributions to the national GDP to the regions). Consequently, according to data on regional GDP, with the exception of Prague, there is little variation in the socio-economic level among the Czech regions. Moreover, the regional distribution of the GDP (with a bit of exaggeration) is of almost random nature, influenced for example by the location of power plants. Consequently, the NorthWest and Ostrava regions, which are the most affected regions in the Czech Republic with an accumulation of serious economic, social and ecological problems, are scoring relatively well on this indicator. Thus, the method based on the regional GDP supports the nationwide approach and favors large-scale projects implemented on central level.

Secondly, the EU delineates lagging regions on a different hierarchical level than would be suitable for the Czech Republic. In the EU, Objective 1 is defined on the basis of the data for NUTS II regions, the definition of Objective 2 is based on NUTS III regions. For the conditions of the Czech Republic, NUTS II regions are rather large, and averages for these regions can easily hide distinctive intra-regional disparities.

Due to limited coordination of supported projects via the principle of programming, the principle of partnership is also often executed only in a formal way. The same criticism also concerns the issue of transparency, where a formally clear and equal approach to all subjects of support programs is applied, when in practice, there is a huge overhang of demand over supply due to the limited amount of financial resources allocated to individual support schemes.

The solution of all these shortcomings is possible only by radical reduction of the number of support programs, and these should be formulated more broadly and should correspond to priorities defined by corresponding national and regional strategic documents.

A possible impetus for such radical restructuring of state support programs, especially of those aimed at support of final beneficiaries from decentralized bodies of public administration, might stem from newly introduced regional self-governments. It is likely that after the period of solving fundamental problems of their very existence, the representatives of new regions would expect that the state to decentralize responsibility over at least some support programs to them. Another impetus might be associated with likely political changes after the forthcoming elections in June 2002, as the political opposition is arguing that one of the principal goals of regional reform; i.e., the decentralization of some competencies to the regions and consequent slimming of bodies of central administration has not been met, yet. Moreover, the government itself is becoming more and more aware of excessive fragmentation of its support programs. Therefore, it recently decided to shift all responsibilities of support for SMEs to one ministry (The Ministry of Trade and Industry). Currently, the responsibility for regional support to SMEs rests with Ministry for Regional Development. This indicates that the role of this ministry is rather weak. There are even opinions among opposition politicians that, after the parliamentary elections, this ministry might be abolished. This would inevitably cause changes in the package of support programs administered by this ministry regarding their number, focus, and procedural matters.

Nevertheless, the outcomes of all these factors and different interests is difficult to assess, as there are permanent attempts by different pressure groups to establish new support programs, which they consider relevant or helpful. Consequently, it is unlikely that a radical change in the system of support programs would be accepted; a gradual modification of package of support programs is more likely.

From Table 8, it follows that despite all the above-mentioned positive changes, the Czech regional policy is still highly-fragmented in an array of small programs and still departs significantly from the EU cohesion policy. Several immediate implications for reorientation of the Czech regional policy stem from the forthcoming accession. More specifically, by the time of accession into the EU, the very relevance of the existing Czech regional policy would cease. The task of national regional policy should primarily be to eliminate the leverage effect of support from the Structural Funds (SFs) in the form of matching grants, since subjects from poorer regions would not be able to provide sufficient financial resources for co-financing of the eligible projects. Therefore, the Czech regional policy might provide an additional 15 percent co-financing of projects implemented in most needed regions, so the local subjects would be able to access the support from SFs.

In the same vein, the towns and municipalities should already now pay special attention to healthy financial management, as large current debt might prevent them from access to generally very favorable support from SFs in the near future. The municipal debt represents, not only danger for stability of public finances, but, after accession (and partially even now), the CCs will be obliged to proceed towards the convergence criteria defined by the Maastricht treaty. This would most likely require introduction of some form of regulation of municipal borrowing (current regulation in the Czech Republic is weak, and represented only by a rule, that the state does not provide some special grants to municipalities with excessive debt; however, the state is imposing strict control on municipal bond issuing, a proposal for a new Act has been submitted to the Parliament recently). Sound financial management of municipalities is especially relevant, given their expected prominent role in future co-financing of SF programs (municipalities allocate from their budgets more financial resources on investment projects than the state from the state budget itself).

The reorientation of national regional policy towards the EU cohesion policy would also require a change in its time horizon from current annual programs to multi-annual approach. The Czech Republic is also missing evaluation culture to guarantee effective and efficient use of public sources, not only in the sphere of regional policy, but also in public sector, in general. However, along with these mostly technical changes of national regional policy, there are also more conceptual questions, which have to be clarified.

One of the big challenges facing CCs is a gradual switch from the low-road to the high-road strategy of competitiveness (see also Porter 1999). The current advantage of low costs does not offer a sound basis for catching up with the West. Therefore, for example, the current emphasis of the state policy for inward investors, should refocus from traditional investment incentives, firstly to after-care programs that aim at maximizing the positive effects of existing foreign investments, and secondly, at improving their structure towards the industrial branches with higher added value, and with more sophisticated production requiring high-quality human capital. The goal should not necessarily be high-tech industries immediately but medium-tech would be a good start (e.g., service or customers centers of software, audit or consultancy firms operating on a global scale). Secondly, from a regional point of view, it would be desirable to promote less uneven spatial distribution of FDIs. Along with hard measures, like provision of adequate infrastructure, this promotion could also take the form of soft measures, including for example, an application of the concepts of territorial marketing.

However, perhaps the most significant change in the sphere of regional development and regional policy, in comparison with the beginning of the transition, is the appearance of relatively mature subjects, especially of self-government bodies in larger towns, some regional development agencies and other subjects. Since January 2001, these subjects have been joined by the fourteen newly created self-governing regions. The regional self-governments are just now learning how to play their role, and it will take time before they will establish themselves as respected subjects.

Currently, however, even the basic framework for operation of new regions is not established. In some cases, the competencies are unclear, or moreover, additional transfer of competencies are being prepared, and property transferred to the regions is oppressed by huge internal debt etc. However, the most visible symbol of weakness of new regions is the system of their financing. The regions are receiving by far the largest share of their income in the form of special grants for education (about 90 percent of their total incomes). The representatives of the regions are now fighting for a larger share of public budgets, but also for obtaining real *public incomes*, in the sense of theory of fiscal federalism.

In the future, the initiative and qualification of local and regional representatives will thus become important factors of local and regional development. of principal importance would also be a need to shift the priorities in regional development strategies gradually from the currently dominating stress on technical infrastructure towards business support (which is just now starting but is mostly limited to building of industrial zones), and especially towards the development of human resources (retraining, life-long learning etc.), which is a sphere still waiting to be *discovered* by the Czech municipalities. Investments into human resources would increase not only competitiveness of endogenous subjects, but also the attractiveness of the country for investors in industrial branches like tertiary or quaternary sector or, within the secondary sector, in medium-tech and even high-tech industrial branches. Obviously, this task is a challenge, not only for the state, but for other relevant subjects, municipalities, regions, and also for the private firms whose interest in education and research is currently insufficient. These changes would help switch from *low-road* to *high-road* competitiveness strategy, and thus to facilitate a real integration of the Czech Republic into the European economy.

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Investing in Regional Development:

Policies and Practices in Hungary

Károly Jókay

Gábor Szepesi

Table of Contents

1. Introduction

As the previously submitted outline indicates, the following paper is an analysis of the Hungarian development support systems presenting the particular operative features of sectorial and regional support systems, and assessing them along the required criteria. In our analysis, the focus is exclusively on available capital investment and development funds, the facilities induced and implemented through them, and the service coverage indicators.

In this paper, we are not concerned with operating expenses and their distribution.

The overall goal of this study is to serve as a basis of comparison between the support systems of countries, whose development level of is similar to that, of Hungary. In line with what has been agreed on previously, the range of capital investment funding in this paper is limited to infrastructure, business promotion and labor force development.

Our analysis is divided into the following chapters:
A short description of the Hungarian public administration system and model of self-governments/municipalities, with special concern for the allocation of development responsibilities to the various political levels.
A description of significant anomalies in development levels between certain regions of Hungary, and the measurements used to measure and interpret these anomalies (e.g., GDP per capita, sewerage coverage (in percentage), schooling levels/number of residents).
Inventory of financial resources where there are, or should be some regional aspects; i.e., funds and development resources flowing into the public sector, in the areas of:

- Infrastructure;
- Business promotion;
- Labor force development.

Wherever possible, a distinction is made between funds flowing into the sector in terms of their sources: EU, central government budget, non-central government budget resources, local revenues, or municipality loans. The volume of funding will also be identified. The inventory covers the current situation but wherever possible, historic data will also be presented in order to highlight significant trends.

Although we aim to provide a complete inventory, it should be pointed out that, given the initial goal of our assignment, it is particularly the review and assessment of support systems that are highlighted and not the analysis of volumes and trends.

Evaluation Phase

As a primary task, the logical relationships between the regional development principles below are also assessed:

- Concentration;
- Programming;
- Partnership;
- Additionality;
- Transparency and publicity.

Conclusion

This evaluation covers the important financing trends and new elements that are considered important. The dysfunction of the existing financing system will also be touched upon and some general observations will be made.

2. Public Administration in Hungary: A Summary

This section summarizes the key features of Hungary's system of governance, public administration, and details which elements are assigned duties in promoting regional and spatial development.

2.1 GENERAL BACKGROUND

President: Hungary is a republic with the state headed by a ceremonial president chosen by two-thirds of the Parliament. The president is the nominal commander-in-chief of the military, but not directly in the chain of command. The president may propose bills to the Parliament, and can exercise a veto of sorts by asking the Constitutional Court to review bills passed by the Parliament. The president has no influence over the executive branch. The president appoints ministers, ambassadors and other such posts at the suggestion of the government.

The Parliament, the supreme lawmaking body, is directly elected every four years (1990, 1994, 1998, 2002) into one chamber. The distribution of mandates is based upon a national party list, county lists, and a compensation list to ensure votes for the loser are not wasted. In essence, the party with the most votes on the national list receives slightly more mandates than it would proportionately deserve, with a threshold of 5 percent for the national list. This design intends to ensure ability to govern. Since the democratic changes and the first free parliamentary elections in 1990, all three governments have served the full four years of their mandate. With 386 members, several proposals have been floated to reduce the size of the Parliament, or concurrently with a reduction, to add a second chamber. Important decisions, such as laws affecting local government, need a qualified majority; i.e., two-thirds majority approval.

The rule of law is guaranteed by an independent judicial branch, a Constitutional Court, an independent prosecutor's office and subordinate courts.

2.2 PUBLIC ADMINISTRATION

Public administration in Hungary is divided between state public administration, and public administration performed by local government. Hungary has nineteen counties (Nuts III level), over 3,100 municipalities (Nuts V level) with the Nuts II level represented by seven regions with no elected officials, and few functions beyond planning and coordination. The Nuts IV level, though part of governance in Hungary since statehood (1,000 A.D.), exists only as informal micro-regions and associations with no funds, no self-government or administrative functions. Each municipality is equal before the law from a Constitutional perspective, though special funds and tasks are assigned to the capital city of Budapest, its districts, and to over 220 municipalities that have city status or county-rights status. From a hierarchical perspective, there are two elected layers of governance; the Parliament, and over 3,100 municipal assemblies. No intervening layer of self-governance or lawmaking exists.

2.2.1 State Administration

The Government, represented by the Prime Minister and the Ministries, form the core of the executive branch. Since 1990, Hungary has adopted a *chancellor* model based upon Austrian and German practice where the Prime Minister enjoys all the powers of other ministers, as well as special rights of his own, such as recommending appointments to the Presidency. The Prime Minister chairs cabinet meetings and signs all documents on behalf of the Government. The government coordinates and supervises the executive branch, and the central components of public administration, while the Interior Ministry (also in charge of police) oversees the functioning of local government .

The Prime Minister, akin to the German or Austrian Chancellor, is truly *primus inter pares*, and nominates all other ministers. The Office of the Prime Minister, formally headed by a state secretary, may also be lead by a Chancellery Minister, as it has been since 1998. The Chancellery Minister may represent the Prime Minister in his absence, though this role may be assigned on an *ad hoc* basis by the Prime Minister. Since the 1998 election, the Prime Minister's office, has added policy-planning offices mirroring each ministry, and headed by a deputy or state secretary for policy. (See www.meh.hu for a description of the cabinet and for direct links to the home pages of each ministry in the Hungarian system.)

In addition to the traditional ministerial structure, Hungary has a set of national level agencies, authorities and services that provide public administration at even the county and municipal level. These include, for example, the Statistics Office, the Energy Office, the Tax Authority, the Consumer Protection Authority, the Office for Elections and Public Records …etc.

Ministries and the national authorities mentioned above also have so-called *de-concentrated* organs throughout the country, and these organs provide services on a regional or county-basis in technical and regulatory affairs. Examples include regional offices of the Water Authority, Environmental Inspectorates, Tax Offices, etc. Logically, these service-provision entities only have authority within defined geographical and administrative boundaries, and are designed to bring services, regulatory affairs and inspection closer to the population.

Finally, notaries or clerk-administrators at the municipal level not only manage the mayors' offices, but are legally responsible for compliance of local regulations and practices of the law, and also provide a range of public administration services on behalf of the state. These include, but are not limited to: issuing birth, death and marriage certificates, accepting passport and identity card applications, registering voters and changes in address.

2.2.2 Public Administration at the Local Government Level

The Act on Local Government, passed in 1990, created five types of local self-governments; four representing specific settlements and one covering counties. These local governments are organized for: villages, cities, the capital city, districts of the capital city and the counties. There is no subordination of these types of local governments, except in a very narrow set of issues regarding the capital city and its districts. Those relationships are defined in a separate section of the law pertaining to Budapest. Mayors and local assemblies are elected directly by the population every four years, several months after the regularly scheduled national elections. If a government falls, (though none has since the changes in 1990) new local elections do not have to be called. County assemblies are also elected directly, with the assembly electing a president who does not have powers remotely equal to a village mayor.

Each type of local government is equal before the law, assuming voluntary duties as they see fit, as well as carrying out a multitude of tasks as required by law. Hungarian municipal governments (village, city, capital city, capital city districts) are only supervised for legality by a County Public Administration Office. The County Administration Office is a national organization, and only rules on the formal legality of local council decisions. It may not comment on the content of local policies. Local governments, as long as they are able to provide a rather extensive set of mandatory services (over 26 in all), may organize their offices and service delivery systems freely, impose local taxes, create their own municipal charters and operating procedures, as well as form associations with other local governments.

Hungary's local government law encourages the creation of notary districts, essentially sharing a notary among smaller villages in close proximity. There are 536 notary districts in Hungary covering the public administration functions of mostly villages with fewer than 1,000 residents. These villages still have their own budgets, mayors and assemblies. The national budget provides many monetary incentives for the smaller villages to form notary districts, though both the Constitution and the guiding laws prohibit even the hint of coercion. Municipalities are free to form associations for common investment projects, regional and economic development efforts, as well cross-border efforts. The Statistical Office has defined *micro-regions* for data collection purposes only. These micro-regions closely resemble Hungary's historical *ridings*, or circuits that a judge could cover in a day on horseback. Some of the statistical micro-regions overlap legitimate historical micro-regions, though in most cases, informal micro-regions are associations formed by municipalities with regional development, and other grant-seeking efforts in mind.

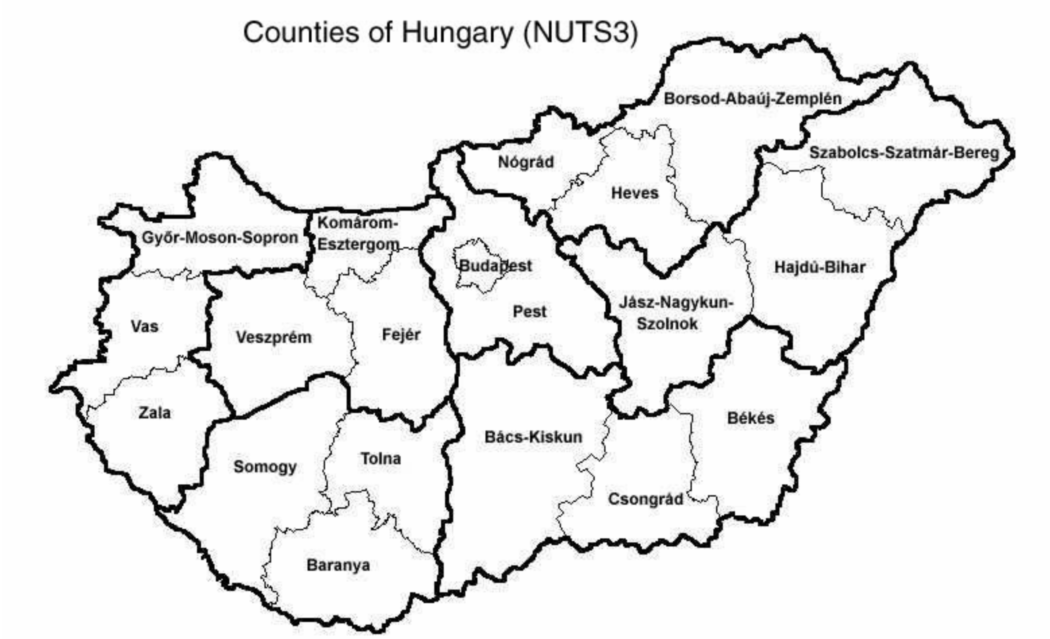
2.3 REGIONAL AND LOCAL DEVELOPMENT ROLES, RESPONSIBILITY FOR BUDGET-FUNDED CAPITAL INVESTMENT PROGRAMS

As indicated before, Hungary does not have self-governing Nuts II level regions with their own budgets, taxation and planning authority. The seven regions were created after nearly six years of intense debate that included options to turn Hungary into one Nuts II region, and general disagreement over defining inter-regional boundaries. Boundaries were not drawn based upon demographic, economic or geographic fault lines. Rather, regional boundaries were determined by political compromise, that is, retaining the 19 counties, and adding them together to form regions.

The next debate, of course, was which *poorer* counties to include in the Central Region dominated by Budapest, which already exceeded 75 percent of the EU reference GDP per capita figure by the late 1990s. Regions stretch laterally over diverse economic and geographic zones in an arbitrary manner. Existing county boundaries themselves have not been radically redrawn since 1920, and do not reflect economic, topographic and political conglomerations. Each county, with a capital city, and perhaps a powerful *second city,* then added to the debate over which city in each region should be considered the headquarters for the regional planning and organizational function. In the end, cities take turns providing headquarters, or county governments rotate in providing the logistical and administrative support needed to conduct those limited tasks assigned to the Regional Development Councils. (See discussion below).

The membership of each region was also contentious in that each region needed a *poorer* member to ensure that its average GDP per capita was safely below the 75 percent EU standard. What was first proposed by the EU as a rational method of ensuring regional cooperation and investment, resulted in seven distorted regions optimizing political and *poverty* considerations, rather than *organic* regional considerations.

Chart 1. Counties of Hungary



The section on regional disparities (based upon the county and the Nuts II level regions as units of comparison) demonstrates the arbitrary and purely illustrative nature of these units.

2.3.1 Who Does What?

Two pieces of legislation guide regional development in Hungary; the 1996 and 1999 Acts on Regional Development. Regional development naturally includes the private, voluntary, non-profit and international sectors. However these laws, in addition to defining the Nuts II regions listed above, assign specific regional development roles (and allude to funding) for the following levels: national, regional, county and the micro-region. Regions have a *partnership* role in this system, while the Nuts IV level micro-regions, only exist as voluntary associations created by the Nuts V level municipalities. As indicated before, neither the Nuts II nor the Nuts IV levels considered critical by the EU pre- and post-accession funding sources, have administrative or self-governing roles; nor legitimacy. Concurrently, the Nuts III level counties, and the Nuts V level municipalities, both of which possess democratic legitimacy, and have true public administration functions, lack funding and authority to conduct capital investment for regional development. This political and economic tension has made it difficult for Hungary, as a whole, to organize its SAPARD offices, and to develop the skills and institutions needed to eventually compete with successful EU regional grant seekers such as Ireland (one region), Catalonia, or Alsace.

Table 1. Units of Territorial Administration and Governance in Hungary

Level	Institution	Role in Regional Development
NUTS 1	Parliament	Comprehensive regulations and setting basic policy guidelines. Passing the National Regional Development and Planning regulation. Determines spending levels in national budget.
	Government	Proposes legislation to Parliament. Carries out national regional development plan. Sets rules re. central government grants and use of funds. Coordinates cross-border cooperation. Operates the spatial information system.
	Ministries	Cooperates in coordinating sectorial and regional development policies.
	Ministry in charge of regional development	Prepares concept papers, plans regarding national regional development policy. Coordinates development programs, organizes their implementation.
	National Regional Development Council	County Regional Development Councils
NUTS 2	Regional Development Councils	Planning and execution at the NUTS 2 level using state and own source funds. Issues opinions on plans developed by other levels. The national government has significant representation on the council in addition to those representing territories within the region.
	Inter-regional Development Councils	County and Regional Development Councils establish Inter-regional Councils to coordinate priority projects that cross regional or county boundaries, or have national significance. An example would be the Lake Balaton Inter-regional Development Council.
NUTS 2 NUTS 3 NUTS 4	Territorial Offices of State Administration	Executing government policies and representing authority at the appropriate levels.
NUTS 3	County Regional Development Councils	Planning, coordination, plan reviews and grant making at the NUTS 3 level. Members represent territorial interests, but the minister's representative has a quasi-veto by an option to involve the National Regional Development Council as a supervisory body (in case of disputes).
	County Governments	County legislature is directly elected. Accepts spatial planning document. Has limited powers in regional development: coordination and review of higher and lower level plans.
NUTS 4	Micro-regional Regional Development Councils	Voluntary associations of settlements aimed at executing joint projects. Funds and authorizations are provided by its member settlements. These association have limited representation in the county and regional development councils.
NUTS 5	Settlement Self-governments	Provides public administration functions at NUTS 5 level. Directly elected municipal assemblies. Wide array of autonomy and independence in actions. Duties, besides providing local services and governance, include settlement (urban) development, an area not yet fully regulated by law. Other tasks include: planning, joining associations, applying for grants and other funding etc.

2.3.2 Summary Institutional Analysis

Based upon the table above, one may conclude that those organizations with the greatest democratic legitimacy, involving not just governmental bodies, but also citizens, NGOs and private businesses, have the least authority, and certainly no source of funds of their own to conduct regional development. On the other hand, the National and Regional Development Councils and the County Regional Development Councils do, indeed, control funds, for which the municipalities and the micro-regional associations, private businesses and NGOs have to compete. Ministries, national agencies, and other authorities dominate the Regional Development Councils as well as the National Regional Development Council itself. They may decide on the allocation of funds, and supervise their use, while micro-regions, led by municipalities, are in a subordinate grant-seeking position, even though their plans may reflect legitimate cross-sectorial and grassroots interests, both indicators of subsidiary status, and an oft-cited goal of EU funding.

Both the National and the Regional Development Councils make funding decisions, adjudicate potential conflicts among the plans of lower level organizations, supervise and audit the use of grant funds by applicants, and have the power to coordinate and override the goals and plans of lower level organizations at the county and micro-regional level. National ministries and agencies are significantly represented in these organizations, with the Agricultural and Regional Development Minister's veto power over decisions explicit in the law. Both the Regional Councils and the National Council have the authority to rank counties and micro-regions in order of priority and can develop their own systems of classification, albeit in a EU-compatible fashion. The National Council has the following types of members: the chairmen of the Regional Councils, presidents of national level chambers, and representatives of the following ministries, often the minister himself: Agriculture and Regional Development, Interior, Environment, Economy, Transport and Water, Health, Welfare, Education, Finance, Culture and the minister leading the Prime Minister's Office. These ministries are joined by non-voting representatives of various national authorities, agencies and off-budget public foundations.

The Regional Development Councils were only formed under pressure from various EU funding sources that require plans to be made on a regional basis. Instead of creating regional governments or authorities, Hungary's seven *statistical-planning* regions form the target areas for EU funding, and legislation requires that the national budget allocate funds to each region annually. The Representatives of the County Development Councils, the county assembly presidents, are the only elected officials on the Regional Development Council. The rest are delegated in a fashion similar to that of the National Development Council with the potential for a ministerial veto, if need be. Micro-regions formed by municipalities and other groupings and alliances that propose projects have only a consultative role.

The County Development Council is the first level of organization dominated by elected officials of a self-governing body. Their role is to coordinate the various plans of municipalities and micro-regions, as well as of NGOs and private businesses, on at least a county level. The County Development Council prepares financial plans, and takes part in the allocation decisions regarding various national funds available for equalization. The Council makes grants, as well as supervises implementation and monitors the uses of funds. The Council itself may seek funds for its operations and for additional grant making. Some counties have created budgetary agencies to provide administrative support for the Councils. Others use existing administrative staff, or create non-profit foundations, either alone or in cooperation with private enterprises and municipalities. Members include the county assembly president, mayors of cities with county rights within their territory, development associations created by municipalities, as well as others.

Development associations established by municipalities have only one legally mandated function: approving micro-regional development plans. Given that members can only be municipalities, these development associations are governed entirely by elected officials, but ironically may only be grant seekers. There are 176 such micro-regional associations and only 152 “official statistical” micro-regions, indicating that the Statistical Office’s micro-regions do not necessarily reflect “legitimate” Nuts IV level micro-regions that are voluntarily created and organic in nature.

3. Regional Differences in Hungary

3.1. BEFORE THE DEMOCRATIC TRANSITION IN 1990

Before 1990, the socialist system attempted to even out social and economic differences using administrative measures in line with the ideology of the day. Though some progress was made, significant imbalances persisted. Between 1950-90, the most advanced region was formed by heavy industry, (chemical manufacturing and mining in the mountains of northwestern and central Hungary), essentially creating a north-south divide where none had existed before. This industrial zone relied on coal mining, and upon the import of raw materials, such as iron ore from the Soviet Union, and its traditional heavy industry exported on a barter basis and ultimately for “convertible rubles” to the CMEA.

3.2 After 1990

After the political changes in 1989-90, Hungary’s economy rapidly reoriented itself to trade with the European Economic Community, especially Germany. Economic transformation, rapid privatization and quick liquidation of loss-making socialist enterprises, combined with the disappearance of both the CMEA and the Soviet Union, led to dramatic increases in unemployment and even sharper regional differences. Foreign investment poured into Budapest and western Hungary, while areas formerly dominated by heavy industry received scant attention.

3.2.1 The early 1990’s: Economic Crisis

With the collapse of both the CMEA and internal markets, the entire industrial belt faced bankruptcy and high unemployment. With essentially no labor mobility, unemployment in the 20-30 percent range dominated in the formerly industrial towns. However, formerly closed and underdeveloped border regions that did not have industry in the previous period realized that they now had major strategic advantages, due to open borders. Greenfield investment moved from the Austrian border along major roads to Budapest, bypassing the former industrial zones.

3.2.2 Recovery from the mid-1990's

The structural and transformational crisis peaked in 1993-94. Starting then, macro indicators such as unemployment, inflation, public debt, and international sovereign debt began to improve significantly. Services, the financial sector, and export-oriented manufacturing showed significant expansion. The structure of the economy shifted to export-oriented manufacturing and services funded by international greenfield investors in automobiles, electronics and components. The industrial crisis zones remained in place, showing little change as investment and growth took place in areas previously untouched by socialist heavy industry. Agriculture, given a serious capital shortage and essentially closed EU markets, remained in crisis.

Several regions of Hungary began sustainable development in the mid-1990s, reinforcing gaps among the successful and peripheral areas. The development gap between wealthier and less fortunate areas grew, not as consequence of any continuing structural crisis, but rather because of differential growth rates and development patterns. In other words, less fortunate areas also began to improve by the late 1990s. Greater Budapest and the northwest of Hungary, as indicators cited below will demonstrate, increased their advantage over the rest of the country.

4. REGIONAL DIFFERENCES

4.1 Budapest's Dominant National Role

Hungary's capital plays a disproportionately dominant role in politics and the economy. Its economic indicators in many respects are nearly an order of magnitude greater than the nearest large city. The largest gaps in development and other economic indicators are not among regions or cities in rural Hungary, rather between Budapest and the rest of country. When greater Budapest, or an outer ring of villages and cities, essentially a part of the metropolis, are included, then this domination is even more evident. Consequently, the Central Region that includes Budapest is an anomaly.

Budapest, the metropolis with 1.8 million residents within city limits, and another half a million in the surrounding areas, is East Central Europe's largest city, encompassing over one-fifth of Hungary's population. Including the agglomerate areas, Budapest includes nearly a quarter of Hungary's population. Hungary's next tier of large cities barely approach 200,000 in population, resulting in a 10:1 difference in city size between the largest city and the second largest cities. Budapest simply has no competition for resources within Hungary and is thus forced to compete with Vienna and other large cities in Central Europe. Hungary's road and rail network is entirely Budapest-oriented since other regional hubs lie in surrounding countries, and the transportation system has not recovered from the shock of two world wars, and several changes in borders in the twentieth century.

Budapest did not suffer the same shocks from economic and political restructuring as did the rest of the country. Economic and political leadership based in Budapest did not liquidate as many firms as in the rest of country, and an overwhelming share of foreign portfolio and greenfield investment flowed to the capital city. National institutions, governmental bodies and the headquarters of many restructured and privatized companies did their share to retain their employees. When unemployment rose above 20 percent in the industrial belt, Budapest, always a magnet for labor resources, never suffered more than 7 percent unemployment.

Developed infrastructure and a well-trained workforce (more than 20 percent of the over-25 workforce has advanced degrees) with high expectations and consumption laid the groundwork for renewal. Over 65 percent of foreign direct investment in Hungary appeared in Budapest, where services, in particular financial services, dominate the economy. As a result, 35 percent of Hungary's GDP, and more than half of its personal income tax and VAT receipts, are produced in Budapest.

4.2 Hungary Outside of Budapest

Hungary's central statistics office has been calculating GDP (vs. national income) since 1994. The national per capita GDP has been rising consistently since 1994, and is near USD 5,000. (The figure at purchasing power parity is nearly USD 9,000). On a regional basis, the Central Region, Northern and Western Transdanubia lead the GDP per capita list because of the high level of foreign investment and successful structural changes. The northeastern regions, on the other hand, lag behind the national average. The gap between northwest and northeast Hungary continues to grow, as demonstrated by the chart below.

Chart 2. GDP Per Capita by Hungarian Regions, 1999 (1000 HU)

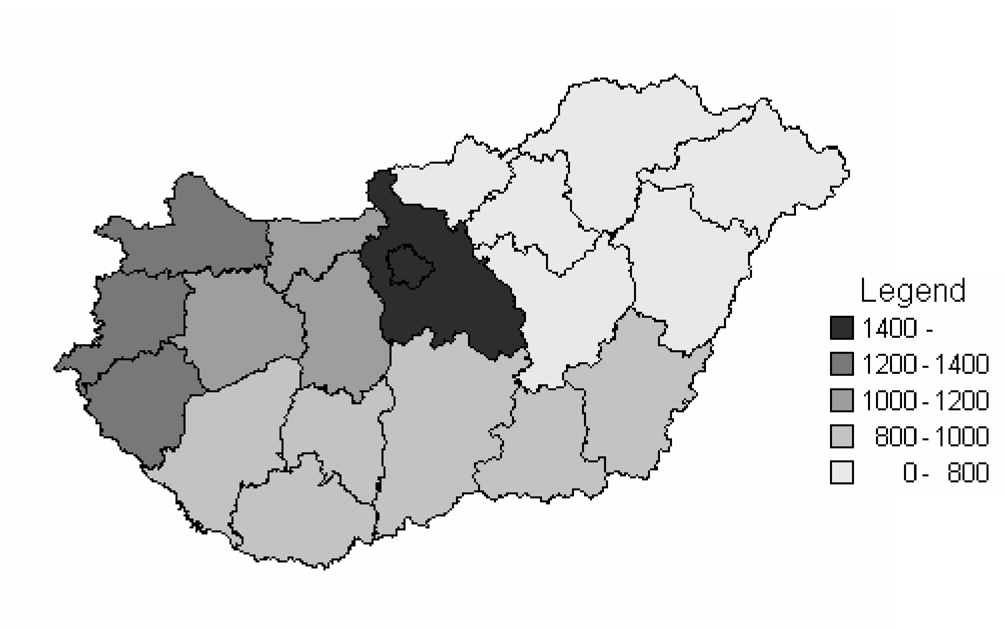
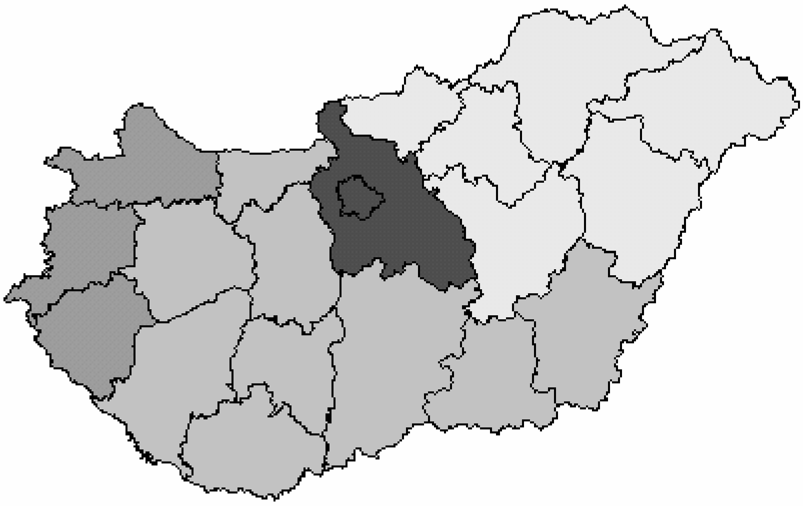


Chart 3. Enterprises with Direct Foreign Investment by Hungarian Regions, 1999



Transdanubia's growth is largely a result of intense foreign investment in automobile, component and electronics manufacturing. Of foreign investment outside of Budapest, 80 percent has appeared west of the Danube, with the balance to the East.

The tertiary sector first emerged as an important factor in the 1960s, though its growth into dominance took place only after 1990 with the collapse of the socialist system. Financial and business services began a significant expansion outside of Budapest, first in the county capitals, then in the large cities that were not capitals. These new financial and business services, often in the form of foreign-owned banks and insurance firms, now have established offices in the third tier cities.

It is interesting to note that the expansion of the service sector took place along the lines of settlement types, not along regional lines. Industry and construction still play an important role in northern Transdanubia as they contribute over 40 percent of regional GDP. New industries show regional variation. In the east, most investments took place in food processing and light industry, while in the west, export-oriented manufacturing and processing dominate (automobiles, auto parts and electronics). In contrast, despite good soil and climatic conditions, the two plains regions' GDP only contains 10 percent value-added stemming from agriculture.

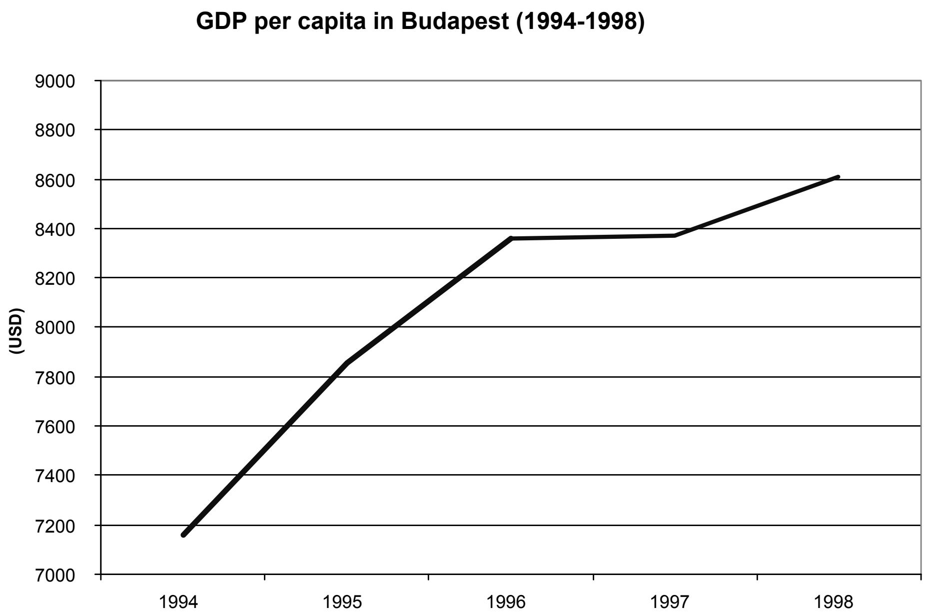
Table 2. Gross Value Added by Main Economic Branches, 1999 (%)

Regions	Agriculture, Hunting, Forestry, Fishing	Industry & Construction	Services
Central Hungary	1.3	24.3	74.4
Central Transdanubia	4.8	46.8	48.4
Western Transdanubia	5.4	47.3	47.3
Southern Transdanubia	8.6	33.3	58.1
Northern Hungary	5.0	39.4	55.6
Northern Great Plain	10.1	30.9	59.0
Southern Great Plain	11.3	29.2	59.5
Total	4.8	32.3	62.8

4.2.1 Unemployment

Official unemployment was first defined and measured in explicit quantities after the collapse of socialism. In the prior system, unemployment was disguised *inside the gate* and kept restrained with administrative methods, or simply not reported as make-shift work was given to all. ("Not working" was considered a crime). After the collapse of the CMEA as an export market and the rapid restructuring of the domestic economy, unemployment reached a maximum of 12.1 percent in 1993 on a national average. (Since then national unemployment dropped below 6 percent signaling that some areas in Hungary actually have labor shortages starting in 2000-1). That 1993 average included a low of 7 percent for Budapest, and rates of over 25 percent in some blighted industrial areas. Unemployment remained below the national average in large cities and Budapest since the social and welfare infrastructure in place allowed low paying jobs to persist. A special feature of Hungary's structural unemployment is that it was not confined to only the depressed zones, but since there were quite a few commuters living in distant villages, their release transmitted industrial unemployment to locations far from the original problem. These long-term, long-distance commuters, who only went home on weekends, were let go first. As a consequence, unemployment that emerged in northern steel mill towns was quickly transmitted to rural agricultural areas in the plains.

Graph 1. GDP Per Capita (1994-1998)



Those agricultural areas were already in crisis when the newly unemployed commuters returned home. Thus, pockets of industrial malaise spread unemployment nationwide. Fortunately, the crisis broke in 1994 with long-term unemployment and intractable unemployment receding to the original crisis zones. In 2000, national unemployment had dropped to 6.4 percent, with the worst county rate at only 11 percent. By late 2001, the national rate slid below 6 percent, with only 4 percent in Budapest, essentially showing a full employment situation.

Table 3. Average Annual Net Income of Households Per Capita (HUF)

Regions	1996	2000
Central Hungary	234,822	483,539
Central Transdanubia	215,144	455,252
Western Transdanubia	213,767	414,074
Southern Transdanubia	210,504	405,564
Northern Hungary	201,880	379,167
Northern Great Plain	192,008	375,896
Southern Great Plain	208,523	400,249
Total	214,071	425,337

4.2.2 Income and Consumption

Differences in income and consumption correspond directly to regional differences in economic development. Accordingly, the highest indicators are produced by Budapest and northwest Hungary. A useful indicator for the consumption of durables by both the population and businesses are the number of cars per 1000 in population. The most rapid growth was shown in the suburbs of Budapest, as over 200,000 people left the city in the 1990s. The second fastest rate of growth in this indicator was measured, surprisingly in poor northeastern Hungary. However, this indicator shows increased gasoline smuggling activity on the Ukrainian border, as vehicles were purchased, modified and used to illegally import fuel, available at a fraction of the Hungarian domestic price. If we ignore this exception, then northwest Hungary dominates the cars/1000 people indicator, as expected.

Table 4. Passenger cars per 100 households (pieces)

Regions	1996	2000
Central Hungary	38	35
Central Transdanubia	41	46
Western Transdanubia	45	49
Southern Transdanubia	40	38
Northern Hungary	34	35
Northern Great Plain	29	36
Southern Great Plain	35	38
Total	37	39

4.2.3 Infrastructure

Just as with respect to economic and income indicators, on average, western Hungary is in a more favorable position. However, in contrast with these indicators, infrastructural gaps are actually narrowing between and among regions.

Transportation

Both roads and railroads in Hungary converge on a single hub; Budapest. Lateral or transversal connections are missing, which places an extra environmental and transportation burden on the Central Region, including Budapest. Due to bad roads and missing connections, some areas in eastern Hungary are difficult to reach from the more developed regions. This reinforces the tendency of greenfields investors to prefer western Hungary and the high-speed motorway connection between Budapest and Vienna. Poorly built or underdeveloped infrastructure may be blamed for the relative backwardness of southern Transdanubia compared to the north, despite proximity to the Austrian and Slovenian borders. Significant expansion of the highway network did not take place in the 1990s, with the densest network around Budapest, and in areas with many small villages. The Budapest-Vienna limited access highway was completed in the mid-1990s, as was the reconstruction of a major rail line in the same direction. Since 1999, road construction has continued along two axis: one towards Szeged and the Yugoslav border, the other east through Nyiregyháza to the Ukrainian border.

Infrastructure at the Settlement Level

The gap in urban infrastructure, such as water, gas and sewage treatment, as well as telephone service rapidly closed during the 1990s. This meant an improvement in living conditions throughout the country, even in depressed areas. Economic renewal was not hostage to the lack of water, gas, or phone lines. Instead, it was largely determined by factors such as proximity to borders and transportation access. Regarding water treatment, there is nearly universal access to piped drinking water in Hungary, while access to sewage treatment is more limited, largely dominated by Budapest. A few large cities lack of even primary treatment for most of their wastewater. The EU has given Hungary until 2015 to close the gap between water and sewage treatment for all settlements with population equivalents over 2,000.

4.2.4 Information Age

Human Capital

Well-trained and educated workers are evenly distributed throughout Hungary's regions, once discounting Budapest's numerical dominance. The least-trained and educated workforce exists in northeast Hungary and in the plains areas. One reason may be that the best-qualified young workers leave their home regions for Budapest and western Hungary, leaving behind less qualified and older peers. A German automobile manufacturer in western Hungary recruits heavily in the east and provides housing and relocation benefits as well.

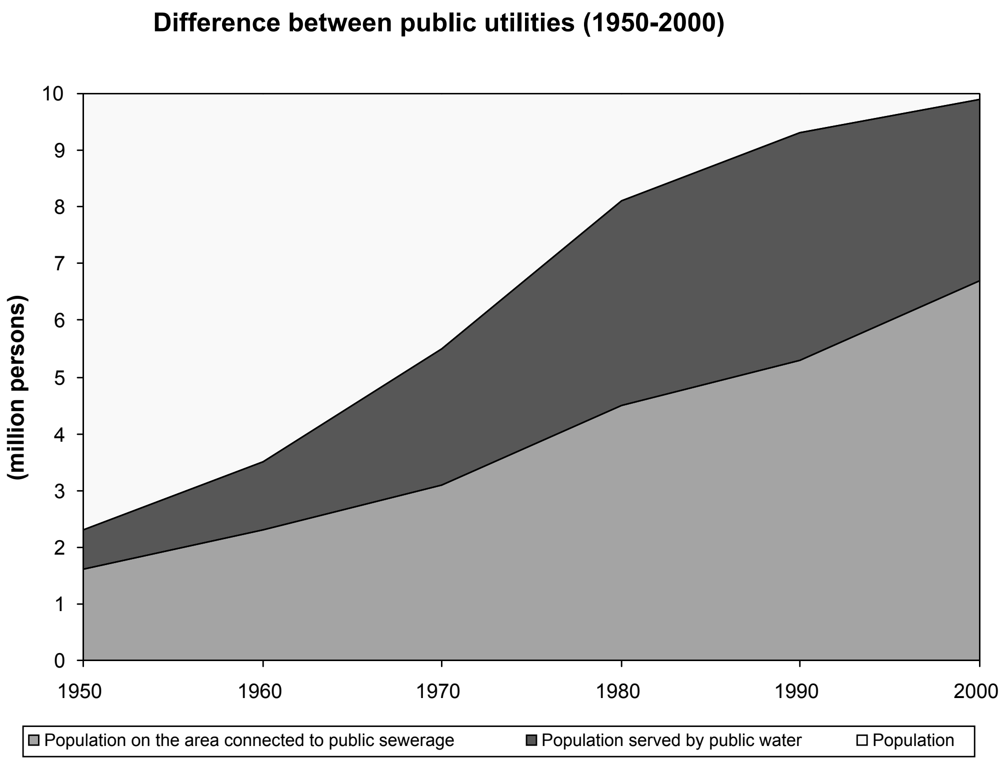
Equipment

Data on the availability and use of telephones and personal computers cannot keep up with developments in Hungary. Given privatization and deregulation of local, long distance and international phone service, and the division of the country into concession zones, the entire country is saturated with digital phone service, including ISDN and ASDL lines. By the end of 2001, there were over 40 phone lines per 100 residents, with mobile phone penetration reaching 50 percent on December 31, 2001. In essence, telephone service is universal, rapidly improving in quality, and very price competitive in all of Hungary. Regional differences in access and use of personal computers are not drastic, with wealthier regions showing more personal computer ownership. Access to computers in poor areas is provided by nearly 400 *telecottages,* or tele-service centers that compensate for lower personal ownership of such equipment. (see www.telehaz.hu and cite Jokay article for Nispacee).

Table 5. Mobile Phones and Personal Computers Per 100 Households

	Mobil Phones Per 100 Households (Pieces)		Personal Computers Per 100 Households (Pieces)	
Regions	1996	2000	1996	2000
Central Hungary	4	29	12	17
Central Transdanubia	3	35	7	22
Western Transdanubia	3	22	9	15
Southern Transdanubia	2	25	6	10
Northern Hungary	1	19	5	12
Northern Great Plain	2	28	7	12
Southern Great Plain	2	25	5	10
Total	3	27	8	14

Graph 2. Differences between Public Utilities (1950-2000)



4.3. SUMMARY

When using regions as a basis for comparison, Central Hungary with Budapest dominates all indicators of economic development and output. In addition, the two northern Transdanubian regions form the top third. South Transdanubia, however, shows a lack of development similar to areas in the plains, or northeastern Hungary.

Development trends show an increasing gap in terms of income, consumption and general economic development between the most developed and least developed regions. On a positive note, urban and settlement infrastructure such as water, gas and sewage service, has shown significant narrowing of gaps among the wealthy and less fortunate areas of the country.

For the sake of accuracy, differences within each region are often larger than differences among regions. Since each region is a conglomeration of poorer and more developed counties and micro-regions, comparing regions involves creating averages that may not apply to any specific place within the region. Each region contains successful micro-regions, groupings of villages or urban areas, whose results are mired by the effect of the rest of arbitrary region.

Development seems to follow axis completely unrelated to the boundaries of the Nuts II regions or other political units, while other forms of development converge on and emerge from city-states, that act as islands in otherwise failed regions. (An example would be the city Nyiregyháza, with only frictional unemployment, surrounded by a county with an unemployment rate ten times the rate of its county capital.

Regional development programs intervene in market trends by attempting to catch up poorer regions, but the overall effect of such interventions pales by comparison to the volume of market-driven funds, that create and reinforce these regional tendencies and differences.

5. Inventory of Financial Resources — Major Funds and Development Resources Flowing into the Public Sector

5.1 DEVELOPMENT OF THE DOMESTIC INFRASTRUCTURE AND SOURCES OF SUPPORT

5.1.1 The Definition of Infrastructure In Economics

The focus of the following analysis will cover Hungarian infrastructure that includes facilities either directly or indirectly indispensable for the alleviation of regional anomalies, upgrading underdeveloped areas, and the provision of development opportunities for a given geographical unit, municipality, region, self-government or population.

The definition of infrastructure includes primary industry and service generation factors which are regarded by several industries, regardless of their output, as their input elements. Their presence is indispensable in regional development and the effective organization of production, consumption and services. Infrastructure could also be described simply as an economic base, nevertheless, this term is deemed not to be definitive enough.

As it has been agreed on previously, the present analysis will include the following elements in the concept of infrastructure: water pipes system, sewerage, gas network, telephone system, network of roads, industrial parks and tourism. These infrastructure elements serve as the basis of regional economic development.

5.1.2 Inventory of Financial Resources

This chapter covers the funds that are contributed to regional development projects, and the relevant volumes are indicated. Here, only such funds will be discussed that have or ought to have some regional aspects.

Act LXV of 1990 on Local Self-Governments/Municipalities, requires the municipalities to carry out a wide range of activities in relation to the provision of public services. The Act stipulates activities that underlie the development and overall functioning of the local community, and on the basis of which, technological-technical infrastructure can be implemented, and at least the basics of communal water management, storm water drainage, sewerage, public and communal sanitation, and human resource related services can be provided.

However, the legislative stipulation of all these responsibilities was not followed up by the allocation of adequate central funding, and consequently the limited financial possibilities of the self-governments and municipalities proved to be a barrier to embarking on the necessary infrastructure development projects.

The insufficiency of funds contributed by the self-governments and municipalities themselves, caused the environment protection projects to become far too dependent on central budget allocation, and the volume of renovation projects falls short of covering the annual depreciation rate of assets.

Now, that accession to the EU is approaching, there is an increasing need for local public capital investment infrastructure projects. However, given the high number of austerity measures, the level of government support provided for self-governments and municipalities is constantly decreasing. Therefore, in view of the decreasing real-term revenues of self-governments and municipalities, a shortage of funding for capital investment projects can be expected in the upcoming years.

In the following, the characteristics of the most important sources of funds are reviewed, together with the time horizon of their allocation, and also touching upon the funding difficulties arising from fluctuations in timing.

5.1.3 Targeted Grants

Every year, the Ministry of Transport, Water, and Communications issues a communiqué by July 15, setting the specific (unit) costs of water and waste management investments using targeted grants, as applicable to funds requests for the following year. No support is available for costs in excess of these levels.

These specific (unit) costs are valid for all investments throughout the country and are strictly standardized amounts.

Unit costs always reflect the implementation costs of the previous year. Thus, on the one hand, the targeted support system does not account for inflation in Hungary (10 percent in 1999). On the other hand, however, it does it take into account less capital intensive, alternative technologies currently in use in Austria and other EU members like Germany, which somewhat offsets the impact of inflation.

Disbursement of the awarded targeted grants takes place through the primary banker of the local government, which charges for this service. Therefore, the provision of state grants is not free due to substantial transaction costs for both the local government and the state. A period of seven to twenty-one days passes from the availability of local government matching funds until vendor invoices are paid.

5.1.4 The Environmental Fund Targeted Budgetary Appropriation ('Kac.')

For capital investments and development projects directly enhancing environmental and natural protection in Hungary, applications may be submitted to the Environmental Fund Targeted Budgetary Appropriation, for;

- Non-reimbursable support;
- Reimbursable, interest-free or reduced-interest support;
- Loan guarantees;
- Interest subsidies.

With several forms of support employed together, the support may amount to 60 percent of all development costs. Municipalities may submit an application if they have matching funds of at least 20 percent of the investment costs. In relation to the allowable cost, non-reimbursable support may amount to:

- 25 percent for wastewater treatment facilities;
- 20 percent for sewage systems;
- 20 percent for municipal solid waste dumps.

Due to the lack of expert-level discussions between the appropriate ministries, the investment cost accepted for Kac may differ from the cost accepted for the targeted support; i.e., there may be situations when the purchase of certain fixed assets is supported by one source of state funding, but not the other.

Kac applications are submitted on an on-going basis, until September 20, while the decisions are made quarterly.

- by April 20, in respect of applications received by March20 of the same year;
- by August 20, in respect of applications received by May 20 of the same year;
- by November 20, in respect of applications received by September 20 of the same year.

The largest group of local government infrastructure investments consists of sewage and solid waste development projects, with Kac supporting those local governments that have been awarded targeted grants. Targeted support applications are reviewed by the end of May; therefore, it is not practical to submit applications for Kac by March 20. It is important to note that Kac support is not available on investments that had commenced before the application was submitted. (not available for projects that were started with private capital).

A local government, whose application has been granted, enters into a contract with the Ministry of Environment, stipulating as coverage for the support, a marketable property secured with a mortgage and/or cash-based bank guarantee. For non-reimbursable support, the property offered as coverage must be unencumbered and free of legal claims and its value must be at least twice the amount requested. The support is utilized piecemeal in stages, as specified in the timetable attached to the grant application. The Hungarian State Treasury disburses the grant support retroactively, upon receipt of vendor invoices. In practice, this means that the local government must advance the support out of its own funds for 30-90 days, before getting reimbursed by the Treasury. As a result, many local governments resort to short-term borrowing thus incurring additional fee and interest costs.

5.1.5 The Water Management Targeted Appropriation (VICE)

Support can be applied for from the Water Management Targeted Appropriation for the implementation of water management projects. The support may take the following forms:

- non-reimbursable;
- reimbursable, interest-free;
- reimbursable with reduced interest; (may be 20 percent of the investment amount, but not more than 100 million HUF).

Applications for VICE must relate to new investments, this support is not available for ongoing investments. The awarded support must be utilized according to the approved schedule. Any support not utilized during the year will be withdrawn, unless it is rescheduled.

The latter can be done only once in well-justified, extraordinary cases. If rescheduled, the support is converted into an interest-free or reduced-interest reimbursable loan. The awarded support is disbursed on the basis of an implementation confirmation note by the appropriate Water Management Directorate and a copy of the invoice corresponding to the appropriate implementation and funding phase. Since funding is retroactive, the local government pays an advance, as with Kac support, usually for 15-30 days, and finances it by taking a revolving credit.

5.1.6 Rural Development (Regional Development) Targeted Appropriation

The regional development councils in the counties and the National Regional Development Council determine the recipients of for the Rural Development (Regional Development) Targeted Appropriation. From the budget available, the regional development councils in the counties award:

- non-reimbursable support
- reimbursable support
- interest subsidies (energy, water and sewage system construction, waste disposal and treatment)

The top limit of the support is 20 percent of total justifiable costs for non-reimbursable support and 30 percent for reimbursable support. The deadline for applications for the current-year support is August 31. The first allocation decision is made on May 31, and after that decisions are made within sixty days of receiving the application. The support may be utilized together with local public matching funds, corresponding to the appropriate implementation phase and against an invoice or a payment receipt.

5.1.7 Support for Regional Equalization Projects

The regional development councils may award support to local governments applying for construction of infrastructure within the communities or certain areas of communities and renovation and development of existing infrastructure networks in inner and outer areas of the community.

Local governments in areas classified by regulations as a high regional development priority. Local governments with inferior infrastructure, and who are considered socially and economically disadvantaged, with an unemployment rate significantly higher than the national average, may submit applications for development projects to be implemented by the local governments. The support takes the form of a non-reimbursable capital grant which covers up to 70 percent of project costs, if the remaining 30 percent is covered by a non-government entity. Otherwise, the amount of allocation drops down to 40 percent; i.e., for those projects that already have been funded by the state, for those that have been granted other state support. The application deadline for the current-year support is August 31. The first grant allocation decision are made by 31 May, and after that, within 60 days from the day of receipt. Support is disbursed strictly in accordance with the above specified procedures.1.3.6 EU funds.

On September 3, 1990, the Republic of Hungary and the EU Commission signed a framework agreement setting out the overall rules guiding the allocation and receipt of PHARE support. PHARE has its own set of rules, and operates with the help of co-financing funds. It supports local government investments within the framework of the Environmental

Fund Targeted Appropriation. The support is disbursed in non-reimbursable and reimbursable form. Support is disbursed following each implementation step, in accordance with the percentage ratio stipulated in the contract agreement. Following accounting regulations in Hungary, the amount of support is determined in euros while local governments are paid in forints. The vendor also invoices in euros at a later date, and the local government has to buy back the euros, possibly at a worse exchange rate, to pay the vendors. As a result, under this funding scheme, local governments are exposed to debt.

The PHARE program has been present in Hungary since the 1990s and ISPA and SAPARD programs have been available for a few years in Hungary.

On June 21, 1999, the Europe Council issued three decrees to regulate the coordination of these three funds that are meant to facilitate the associate countries' preparations for accession to EU.

The Berlin Europe Council session of March 24-25, 1999 passed a resolution that finalized the budgets of these programs. (see Table 6)

Table 6. PHARE, SAPARD and ISPA Budget Resolution

Millions [EUR]	2000	2001	2002	2003	2004	2005	2006	Total
Pre-accession funds	3.120	3.120	3.120	3.120	3.120	3.120	3.120	21.840
PHARE	1.560	1.560	1.560	1.560	1.560	1.560	1.560	10.920
SAPARD	520	520	520	520	520	520	520	3.640
ISPA	1.040	1.040	1.040	1.040	1.040	1.040	1.040	7.280

The budget for the individual programs was defined for ten East Central European countries striving to join EU. The amounts to be allocated to the individual countries were agreed on in a series of negotiations. The coordinated use of the three funds by the recipients is an explicit EU requirement. The funds are to be allocated within each country through tendering.

PHARE Program

PHARE (Poland Hungary Assistance for Reconstructing the Economy) is an EU program that provides non-reimbursable support for Central and East European countries, the goal of which is to facilitate the implementation of social and economic reforms and support preparations for integration.

Since 1995, PHARE has offered to Hungary steadily increasing support opportunities in the areas of regional and economic development. During the first years the allocated funds had accumulated and by 1998 the situation had become rather confused. Since then, significant progress has been made, e. g. the Central Finance and Contracts Unit, CFCU, was set up in accordance with an agreement signed by the Government of the Hungarian Republic and the EU Commission on December 1, 1998. The table below reflects a surge of funding after 1998.

Table 7. PHARE Funds Made Available To Hungary From 1995-2002

Millions [EUR]

1995	1996	1997	1998	1999	2000 (preliminary)	2001 planned	2002 planned
99.3	109.3	104.0	94.0	131.3	232.8	240	240

If we compare the above mentioned two data sequences it is clear that there can be a significant variance between the earmarked budget and actually contracted amount.

By 2000 the budgeted amount is already significantly supplemented by the government budget because only three of the seven Hungarian regions are entitled to PHARE support (North-Hungary, South-East-Hungary (Dél-Alföld), East-Hungary (Észak-Alföld). However, the Hungarian government considered it a national priority that all the seven Hungarian regions have equal chances during the preparations for the accession. Therefore the government decided that each region which from 2000 is not entitled any more to PHARE support would be provided with government funding of such an extent that allows for the implementation of a program corresponding to GOAL 1 of the Structural Funds, or if you like, to a PHARE shadow program.

SAPARD Program

SAPARD (Special Accession Program for Agricultural and Rural Development) which became effective as of January 1, 2000, in accordance with Council Decree 1268/1999, promulgated on June 26, 1999, in addition to PHARE and ISPA, is one of the support programs through which the European Union offers support to the associate member countries to facilitate preparations for full membership.

In accordance with Subsection 1 of Section 8 of Council Decree 1268/1999, the Union's contribution to Technical Support Measures may in certain cases reach 100 percent of the justified costs.

In such cases, where the degree of Union support exceeds 75 percent, the justification, which also includes the suggested rate of support, is to be submitted to the Commission for approval prior to the use of the funds.

ISPA

The Instrument for Structural Policies for Pre-accession (ISPA) is one of the European Community's financial instruments, set up to assist the ten Central and East European candidate countries prepare for accession. ISPA provides financial support for investment in the areas of environment and transport, in order to speed up the compliance of accession countries with the European legislation currently in force in these two sectors.

The legal foundations of ISPA are laid down in the Europe Council Decree 1267/1999, ISPA regulation, of June 21, 1999. In pursuance of the resolution of the Berlin summit, ten East and Central European member candidates (excluding Cyprus) are entitled to ISPA support between 2000 and 2006. When the member candidates join the Union as full members, their entitlement ceases, and the amount allocated to them will be distributed among the remaining member candidates.

Since 2000 ISPA program has allocated to Hungary EUR 270 million in support of environment and transport development projects, which represent a total value of EUR 559 million.

5.1.8 Széchenyi Development Plan

Széchenyi Development Plan is a central investment enhancing device for regional development, focusing on projects involving public and private actors in the sectors of tourism, logistics and energy.

In order to facilitate and accelerate the implementation and achievement of the goals and the programs laid down in Széchenyi development plan, the Ministry of Economic Affairs defines the following fundamental considerations for awarding and using appropriated funds:

- Development of human resource and IT culture of businesses, the improvement of utilization of IT instruments and infrastructure, and facilitating better access to them;
- Increasing the revenues and effectiveness of tourism by the development of domestic tourism, by the development of internationally competitive products for tourists, the preservation of the country's cultural heritage and natural environment, and the improvement of the quality of services;
- Strengthening the regions' internal economic cohesion by direct network development program support.

5.1.9 Job Creation and the Preservation of Existing Jobs

- The achievement of compliance with the European Community's industrial and environmental standards, and assisting businesses in doing so;
- Rural development and improvement of rural infrastructure as well as that of the rural residents' job prospects and quality of life, with special regard to disadvantaged agricultural areas;
- Upgrading the national economy to meet European Union expectations regarding accession, and bringing the market economy and institutional environment in sync with the relevant requirements.

5.1.10 Resources Contributed by Self-Governments and Municipalities (Matching Funds)

A prerequisite for the allocation of government support for the implementation of municipality/self-government capital investment projects is matching funds contributed by the municipalities/self-governments themselves, as stipulated by legislation. The availability of the necessary matching funds is to be verified by virtue of the resolution of the given representative body, current account statement of the bank or a signed loan contract.

Sources of financing matching funds for municipality/self-government (henceforward: municipality) public utility investment projects include:

- Savings and revenues of the municipality,
- Revenues arising from the sale of assets,
- Loans taken by the municipality.

The municipalities' savings depend on how local revenues can be mobilized and expenditures can be optimized.

The rationalization of expenses has been going on for years and the generated savings in costs and operating expenses are spent by the municipalities on the improvement of the quality of services.

Local revenues can be increased by increasing local taxes and the more effective sale of municipality services.

The municipalities tend to be restrained in using their powers to levy taxes, partly due to political considerations and partly because of the ineffective institutional incentives and poor tax management capacity. Therefore, local tax revenue has not played, and probably will not play a determining role in financing capital investment projects.

With regard to the provision of matching funds for capital investment projects, the revenue generated by the sale of the following three major groups of municipality services should be mentioned here:

- Letting out real estate (land and buildings) owned by the municipality. The company implementing the capital investment project rents office space, sites or accommodation for their staff from the investing municipality. The company pays the rent for the services thus used, which in turn is used by the municipality to pay vendor invoices.
- The municipality acting a subcontractor: the company set up by municipality acts as a subcontractor in the implementation of the project. The subcontractor carries out the activities determined by the contractor in a contract, for which the subcontractor receives payment. The amounts thus received for the said activities are put towards the matching funds to be put up by the municipality.
- Loans provided by the municipalities by the contractor and/or by financial investors.

Subsequent to the conclusion of the principal contractor contract, the contractor also concludes a loan contract with the municipality. The amount of the loan is determined, on the one hand, by the financial situation of the investor and, on the other hand, by the financing gap that the municipality would like to fill. When the loan contract is signed, the municipality commits itself to spending the revenue generated by the use of the facility constructed by the given project on the repayment of the loan. Depending on the investor's intentions, the investor can submit a bid for the utilization of public utility when the tender is announced. The municipality arranges for the operation of the constructed public utility (the provision of public service) either by leasing or through a concession. The revenue arising from the lease/concession is to cover the amount of the loan.

The Act on Municipalities enacted in 1990 allocated a significant volume of assets to the municipalities**.** The sale of municipality assets (land, real estate, securities) accounted - up to the mid-1990s - for a significant portion of municipality revenues, that were spent to finance capital investment projects. However, this source of capital investment financing, i. e. the sale of assets, has by now lost its significance, because of the depletion of marketable assets: it is only primarily the basic municipality assets, which may not be sold, the hard-to-sell business shares of municipality companies and the hard-to-sell shares, that have been retained by the municipalities.

Market loans taken by municipalities imply either the direct issue of bonds or commercial bank credit lines.

The overall volume of bonds issued or loans taken to finance municipality infrastructure projects is not significant in spite of apparent demand. There are several reasons that account for the low volume of loans:

- In pursuance of Act LXV of 1990 on Municipalities, the upper limit of municipality commitments which generate debts (loans taken including charges and commissions, issue of bonds guarantees and surety commitments, lease) may not exceed 70 percent of the amount planned for in the municipality budget in the line item of annual total adjusted operating revenues;

- A small or medium size municipality is not able to have direct access to the long-term loans markets;
- Poor chances for long term loans;
- Lack of information on loan opportunities, poor principal repayment and interest payment capabilities.

It follows from the above that loans, as a source of funding, do not play a decisive role in funding municipality capital investment projects.

5.2 THE VOLUME OF THE INDIVIDUAL INVESTMENT SOURCES AND DEVELOPMENT PROJECTS IMPLEMENTED SO FAR

This chapter analyses the volume of regional development expenditure in the individual sectors, i. e. the role the government plays in the sectors of water management, sewage, waste management, provision of gas, industrial parks and tourism.

Primary data are available on the magnitude of funds flowing into the individual sectors but it is difficult to identify the distribution of funding sources per individual project or project type.

The available set of data clearly reflect the magnitude of certain centralized funds, e.g., the absolute and relative volume of targeted and addressed support grants allocated to capital investment projects. The distribution of the funds used and their absolute volume by segment can not be identified. In other words, there is no national or regional breakdown to indicate the volume of TEKI, VICE or Kac grants by individual completed infrastructure project.

In our judgment, the original goal of this paper does not include minute analysis of funding sources from an accounting perspective, but rather, the goal is to explore the relationship and coordination between the components involved in the funding.

In view of the available primary data, we will demonstrate the ratio of the expenditure of capital investment, accumulation in a given sector to the total accumulation expenditure.

5.2.1 Gas network

In 2000, the Hungarian communities spent a total of HUF 832 million on the construction of gas networks, of which HUF 30.3 million was spent on renovation, HUF 163 million on new facilities, HUF 540 million on transfers outside public sector funding, HUF 20.6 million on transfers within public sector funding, and HUF 74.4 million on the repayment of loans. The entire expenditure amounts to 0.2 percent of the municipality development total expenditure, while the accumulation expenditure per capita is a national average of HUF 81.

It should be noted that voluntary residential gas associations constitute the backbone of the peculiar gas development practice. These associations finance their developmental projects primarily from loans, and the completed facilities are, in turn, contributed in-kind to the gas service provider.

Some of the facilities completed by development projects financed by residential contributions had to be transferred by the municipalities to the gas service provider free of charge. It took a number of years and lawsuits, involving the Constitutional Court too, until 1998, when the municipalities were awarded HUF 50 billion in damages.

The figures indicate that most of the involved municipalities transfer the funds to the service providers as a contribution to the development projects, and service providers complete the facilities through their own capital investment projects. Funding for municipality developmental projects is made available on a competitive tendering basis by Kac, TEKI and the rural development targeted appropriation.

5.2.2 Construction of Local Public Roads

In 2000, the Hungarian communities spent a total of HUF 44,313 million on the construction of road networks, of which HUF 10,181 million was spent on renovation, HUF 20,811 million on new facilities, HUF 8,214 million on transfers outside public sector funding, HUF 34 million on transfers within public sector funding , and HUF 74.7 million on the repayment of loans. The entire expenditure equals 11.2 percent of the municipality development total expenditure. Non-reimbursable VAT amounts to HUF 5,000 million.

It should be noted that the road construction projects, implemented by the municipalities, do not include the capital investment and maintenance expenditure of roads managed by the Public Road Management Directorates, nor do they include the construction costs of high priority motorway and bridge projects. The latter categories are covered by the appropriations of the Ministry of Transport and Water Management, constituting a budget of HUF 62,500 million in 2001 and HUF 71,800 million in 2002 for road maintenance and development across the country.

5.2.3 Telecommunication

In Hungary, telecommunication is operated entirely through the involvement of residential and private capital, the capital investment projects of the land based service providers without any supplementary government funding.

Since there is virtually no regional development funding available for such projects, this subject will not be addressed in detail here.

5.2.4 Community Water Supply and Water Quality Protection

Drinking water pipe networks had been laid across almost the whole country by the mid-1990s, and consequently such projects were removed from the development goals of the targeted development support program. Nevertheless, funds for individual development projects are still awarded in the form of addressed grants.

In 2000, the Hungarian communities spent a total of HUF 916 million on the construction of water pipe networks, of which HUF 160 million was spent on renovation, HUF 558 million on new tangible assets and intangible assets, HUF 113 million on transfers outside public sector funding, and HUF 25 million on the repayment of loans. The entire expenditure corresponds to 0.23 percent of the municipality development total expenditure. The reimbursable VAT of these projects amounts to HUF 75 million and non-reimbursable VAT amounts to HUF 133 million.

Targeted support used for such projects, carried over from previous years, amounts to HUF 2.8 million, and addressed grants amount to HUF 68 million.

The penetration rate of sewage is much lower, it is approximately 50 percent. Small scale water quality protection and drinking water supply projects are typically financed by residential contributions whereas similar projects of several million forints are also supported by VICE and addressed grants as well as by TEKI managed by the regional development councils and the rural development appropriation.

5.2.5 Sewage Disposal and Treatment

This is the type of capital investment project which is most favored by the Hungarian support systems since the penetration rate in this area is rather low, so there is a substantial need for such infrastructure development projects.

Support funds are provided by the following central budget sources: targeted and addressed grants, targeted decentralized funds and TEKI under the Ministry of the Interior, KAC under the Ministry of Environment, VICE under the Ministry of Transport and Water Management, and regional development targeted appropriations, and regional funds managed by the regional development councils under the Ministry of Rural Development.

Of the international support systems, ISPA and PHARE, too, provide development funding for sewage treatment programs.

In 2000, the Hungarian communities spent a total of HUF 73.2 billion on sewage disposal and treatment projects, of which HUF 1.1 billion was spent on renovation, HUF 54 billion on new tangible assets and intangible assets, HUF 2.7 billion on transfers outside public sector funding, HUF 2.4 billion on transfers within public sector funding , and HUF 7 billion on the repayment of loans. The entire expenditure corresponds to 18.5 percent of the municipality development total expenditure. The reimbursable VAT of these projects amounts to HUF 7.8 billion and non-reimbursable VAT amounts to HUF 13.7 billion.

In 2000, municipalities used for such projects HUF 19 billion targeted support and HUF 169 million addressed grants. The accumulation expenditure per capita was HUF 7000 in 2000.

5.2.6 Construction of Solid Waste Landfills

Similarly to the sewage program, this issue is one of the most sensitive areas of Hungary's infrastructure development. The construction of solid waste landfills, which is a component of the overall goal of the neutralization of waste, receives support from the following central budget sources: targeted grants and addressed grants, targeted decentralized funds and TEKI under the Ministry of the Interior, KAC under the Ministry of Environment, VICE under the Ministry of Transport and Water Management, and regional development targeted appropriations and regional funds managed by the regional development councils under the Ministry of Rural Development.

In 2000, the Hungarian communities spent a total of HUF 2.2 billion on such projects, of which HUF 5 million was spent on renovation, HUF 1.6 billion on new tangible assets and intangible assets, HUF 2 million on transfers outside public sector funding, HUF 104 million on transfers within public sector funding , and HUF 0.5 billion on the repayment of loans. The entire expenditure corresponds to 0.55 percent of the municipality development total expenditure. The reimbursable VAT of these projects amounts to HUF 419 million and non-reimbursable VAT amounts to HUF 366 million.

In 2000, municipalities used HUF 293 million targeted support for such projects. The accumulation expenditure per capita was HUF 200 in 2000.

5.2.7 Establishment of Industrial Parks

Compared to the sectors discussed so far, industrial parks were addressed by the government relatively late. It was only in November 1996, that the government made a decision on drawing up a development program for industrial parks (which has not been completed yet), and Government Decree 185/1996 (December 1) listed the criteria that qualify a site as an industrial park. In spite of the initial difficulties, by the year of 2000, there were 112 organizations nationwide possessing the title of industrial park, encompassing altogether 950 companies and involving almost HUF 400 billion working capital. The 100,000 workers employed in industrial parks generated a production value of HUF 1,400 billion.

The government provided significant central funds - that were made available on competitive tendering basis - for the establishment of industrial parks. These amounts totaled HUF 400 million in 1996 and HUF 800 million between 1997-1999. At the same time, the total volume of funds used by the capital investment projects were, as follows, in an annual breakdown: HUF 4 billion in 1996, HUF 7 billion in 1997, HUF 24-25 billion in 1998-1999, and HUF 28 billion in 2000. In 2001-2002, support for development of industrial parks comes:

- From the appropriation for the support of active employment goals, and the regional development targeted appropriation for the Hungarian regions managed by the Ministry of Economic Affairs.
- From the regional development targeted appropriation.

The regional development targeted appropriation for the Hungarian regions, which is managed by the Ministry of Economic Affairs, provides support for the establishment of complex infrastructure of industrial sites and for innovative services provided for incubators, innovation centers and businesses set up within the industrial parks. The maximum amount of support is HUF 100 million.

An important criteria of awarding the support is that the development program or project that receives the non-reimbursable support should demonstrate in their business plan that the investment will be recovered within ten years.

The appropriated amount for such targeted support was HUF 5 billion in 2001 and is HUF 6 billion in 2002.

The regional development targeted appropriation offers:

- non-reimbursable support;
- reimbursable support;
- support for the payment of interest on development loans;

for the implementation of industrial parks, and industrial and service sites.

The support amount may not exceed 30 percent of the total net costs of the capital investment project.

Of the existing 112 industrial parks, 45 submitted proposals for industrial infrastructure development support and 37 of them were awarded funds. The volume of the implemented development projects is almost HUF 8 billion.

5.2.8 Tourism Development

The economic significance of Hungarian tourism has increased since 1990, although the revenues thus generated are lower than expected, on the basis of number of visitors.

In view of the favorable impact of tourism on economic growth, foreign trade balance, employment and the upgrading of the economy of the disadvantaged areas, the government issued Government Decree 1100/1995 (October 6) to list the measures and responsibilities that would underlie the development of tourism as follows:

The conditions and possibilities of awarding joint concessions covering the following areas should be investigated: the complex utilization of certain natural attractions owned by the state (except for nature conservation areas) for the purposes of tourism; accommodation and catering based on such attraction factors; and other related services.

Funds should be made available to support the elaboration of regional and local tourism development policies and projects building on the natural environment and cultural values. The development directions thus approved should be a consideration in the regional development and zoning plans.

The national, and thus the largest, fund for tourism development projects is the Tourism Appropriation, which is financed by contributions paid by businesses involved in tourism.

In accordance with the goals of the Széchenyi Plan, Tourism Appropriation awards support for the following areas:

- National and regional tourism related marketing targeting domestic and foreign audiences; promotion activities; tourinform services; creation and publication of promotional instruments (with special regard to brochures, leaflets, publications, films and promotional objects); advertisements; organization of exhibitions in Hungary and abroad; and defrayal of personnel, incidental and capital investment expenses incurred by the distribution of promotional materials and other promotion and communication activities;
- The development and running of a network of tourism offices abroad, and the financing of the following costs: personnel and material expenses of these offices; expenses related to promotion activities ordered and performed abroad; and expenses related to participation in international organizations;
- Support for the organization of programs which represent special significance from the prospective of tourism (particularly cultural and sports events, conferences and congresses);
- The drawing up of development and zoning plans, policies and projects; support for tourism related regional and product development; the development of holiday maker, village bed and breakfast, medicinal, congress, youth, push-bike, water, hiking, equestrian, conference and eco-tourism;
- Conducting research into tourism; conducting surveys; facilitation of the development of a tourism related statistical information database;
- Support for the training of tourism specialists; funding for training aids and materials used by accredited and acknowledged organizations that provide or organize training in tourism; support for practical, hands-on training;
- Support for the environmental programs of hotels and catering units;
- Support for participation in programs that are open to associate EU countries, and involvement in international aid programs facilitating preparations for accession to the European Union.

The appropriation disposed of HUF 6 billion in 1999, HUF 3.7 billion in 2000, HUF 24.8 billion in 2001 and disposes of 28 billion in 2002. The increase of support amounts was coupled with more ambitious goals in the years 2001-2002.

The regional development appropriation awards support in the areas of: the development of village bed and breakfast tourism; implementation of infrastructure projects and the provision of services related to village bed and breakfast tourism, such as horse riding, angling, hunting, and building on the special local features like famous wine regions in the form of:

- non-reimbursable support;
- reimbursable support;
- support for the payment of interest on development loans.

The support amount may not exceed 20-30 percent of the total net costs of capital investment projects.

5.3 BUSINESS PROMOTION AND THE DEVELOPMENT OF LABOR MARKET

This supplementary chapter analyses the areas of business promotion and the development of the labor market. Although these areas lie on the borderland of infrastructure, they were included as development areas in the outline of the present paper.

5.3.1 Definition

In this paper, *business promotion* means business development and business stimulation programs which either directly or indirectly are involved in regional development, and induce the establishment and expansion of the industrial, service or agricultural infrastructure, improve the business climate and environment, and contribute to job creation.

5.3.2 Inventory of Financial Resources

The most important support resources focusing on business promotion are part of the central government budget since the development councils of the Hungarian regions and the regional development councils provide support primarily for non-business actors e.g., municipalities and associations.

These central resources have the following components:

1. Rural development targeted appropriation,
2. Economic development targeted appropriation,
3. Economic development targeted appropriation for the regions,
4. Small and medium business targeted appropriation,
5. Different kinds of tax relief.

5.3.3 Rural Development Targeted Appropriation

The guidelines which bear the name of Expenses Covered by Support for Agricultural and Rural Development Targeted Projects contain the detailed rules of a.) the utilization of support allocated in a competitive system from the support appropriation, b.) the degree and amounts of the support, c.) the allocation of the support for the individual support areas.

Non-reimbursable grants can be used for:

- the implementation of ecology based complex economic development programs
- the development of agricultural activities building on the special local features and the development of the related food processing and sales activities;

- development of traditional handicrafts;
- enhancement of the utilization, processing and sale of local natural non-food raw materials (except for fodder);
- development of village bed and breakfast tourism and agro-tourism;
- the renewal of villages and the implementation of programs facilitating the preservation of the local folklore and material heritage;
- development of the rural infrastructure.

Proposals can be submitted for development projects that are implemented in the public administration area of communities where the number of permanent residents, as of January 1, 2000, is either 120 persons per km^2 or less than that, or the number of permanent residents is 10,000 or less (high priority communities).

Development projects implemented in low priority communities may receive support if the capital investment:

- demonstrably contributes to the development of high priority communities, and;
- is demonstrably implemented within the framework of the local area agricultural structure and rural development program or taps into such programs.

Support for development projects is also available from other sources on a competitive tender basis. The ceiling of the support received by businesses from government sources may not total more than 50 percent of the justified development costs, or 65 percent in the case of small and medium businesses. The proposals are considered along the following general criteria:

- to what extent the development projects meet the goal of the support program;
- to what extent the development project is necessary or justified;
- the reality of the implementation time frames and budget;
- the competence and availability of the management responsible for the implementation of the development projects;
- the economic, environmental and operative sustainability of the development project;
- the impact of the development project on employment levels;
- partnership and to what extent it taps into the local area agricultural structure and rural development strategy.

5.3.4 Economic Development Targeted Appropriations

In order to facilitate and implement the goals and programs laid down in the Széchenyi Plan, the Ministry of Economic Affairs considers the following criteria, when support from the appropriations is awarded and used:

- Support is available for programs or projects which contribute to the achievement of highlighted national economic goals and where the program or the project is likely to be sustainable in the long term - as substantiated
    - a.) by the human resource and material aspects covered by the submitted proposal, as well as;
    - b.) by the financial calculations of the feasibility and business plans.

- The targeted appropriation resources may be used to provide support for legal entities in the areas specified by the decree in the following forms:

a.) non-reimbursable support which may not cover operating costs (henceforward: non-reimbursable support);
b.) non-reimbursable interest support which is related to development loans and is defined on the basis of the current prime rate, be it a variable or fixed interest rate (henceforward: non-reimbursable interest support);
c.) reimbursable support which may not cover operating costs, as stipulated in the support contract (henceforward: reimbursable support).

The support amount may not exceed 100 percent of the total costs acknowledged by the request for proposals. However, the degree and intensity of support may be defined in specific cases differently, as is the case with international aid programs, where the degree or intensity of support is defined by the aid program itself.

The Ministry of Economic Affairs has three separate targeted appropriations in its annual budget that serve the purposes outlined above.

5.3.5 Tax Relief

The editors of the present paper deem, that the different kinds of tax relief constitute an indirect tool of business promotion and regional development, since the preferences of the government are incorporated into the tax policies, thus contributing to the upgrading of disadvantaged areas.

Businesses are entitled to numerous kinds of tax relief that affect their corporate income tax.

The detailed rules of the conditions of tax relief are laid down by Act LXXXI of 1996 on Cooperate and Dividend Taxes. For a summary of the different types of tax relief see the following table:

Table 8. Types of Tax Relief Summary

Tax Relief Focus	Type of Operation	Degree of Tax Relief (%)	Tax Relief Base	Duration of Tax Relief (Years)	Minimum Amount of Capital Investment (HUF)	Commence-Ment of Investment Project	Increase In The Number of Job Holders
Tax Relief For Capital Investment Projects							
Regardless of area	manufacturing capital investment	50	tax	5	1 billion	12/31/95	
Regardless of area	hotel/commercial accommodation space	50	tax	5	1 billion	12/31/96	
High priority geographical area/entrepreneurship zone	manufacturing capital investment	100	tax	5		12/31/95	
Ranked as high priority in terms of regional development	manufacturing capital investment	100	tax	10	3 billion	12/31/96	100 persons
Unemployment rate above 15%	manufacturing capital investment	100	tax	10	10 billion	12/31/96	500 persons
Regional and Other Types of Tax Relief							

High priority geographical area/ entrepreneurship zone	machinery, building, infrastructure	6	value of capital investment				
Tax Relief For Small and Medium Businesses							
Regardless of area	leasing, loan	40	annual interest on the loan		not more than 0.5 million	12/31/00	

5.4 LABOR MARKET DEVELOPMENT

5.4.1 Definition

By labor market development we mean the different kinds of institutionalised support with the help of which structural and seasonal unemployment can be reduced substantially by using retraining projects and special employment support, and by increasing the effectiveness and adaptability of the labor force. The concepts of labor market and regional development are in strong correlation because both of them rely greatly on the simultaneous existence and development of the other one.

5.4.2 Inventory of Financial Resources

Of the EU funds available to Hungary it is PHARE that offers support for the development of labor force.

Human Resource Development PHARE Programs

The implementation of human resource development programs meant to facilitate preparation for successful use of the European Social Fund in the future has close ties with the programs of the current Hungarian support system where the decision making powers lie with the County Labor Councils and Vocational Training Councils. These council are tripartite bodies with membership from government organizations, and NGOs representing the employer and employee sides.

PHARE 2000 contains altogether three human resource development projects, and the implementation of two of them is managed by the European Social Fund Program Management Office KHT. (non-profit organization).

Employability and the Long-Term Employment of Multiply Disadvantaged Groups

Professional coordination: Ministry of Social and Family Affairs - consequently the program is also included in the proposal requests issued by the Ministry of Social and Family Affairs.
Budget: EUR 4 million from PHARE + EUR 4 million co-financed by Hungary = EUR 8 million

Vocational Training

An ESZA type project to facilitate transition from education to the labor market.

Professional coordinator : Ministry of Education

Budget: EUR 4 million from PHARE + EUR 2.53 million co-financed by Hungary = EUR 6.53 million

Social Integration of the Gypsy Minority

Professional coordinator: National and Ethnic Minority Office

Budget: EUR 2.5 million from PHARE + EUR 0.85 million co-financed by Hungary = EUR 3.35 million

The PHARE funds are available through a competitive tendering process.

5.4.3 Central Budget

Labor Market Fund

The most important chapter of the central budget that finances human resource development is the Labor Market Fund. The appropriations for the expenditure, revenues and grants of the Labor Market Fund are included in separate chapters (for years of 2001-2002 see Table 24).

For the annual breakdown of expenditure of the Labor Market Fund see the following table:

Table 9. Annual Breakdown of Expenditure of the Labor Market Fund (HUF million)

1996	1997	1998	1999	2000	2001	2002
91 280.6	120 900.7	142 873.1	152 587.0	162 046.3	178 915.8	193 330.3

At government level, employment policy comes under the Ministry of Economic Affairs, which consequently also manages the Labor Market Fund - within the constraints set by the relevant legislation.

However, the Labor Market Fund also has its own management body, which is called the Management Body of the Labor Market Fund (MAT). This body, similarly to the National Labor Council (OMT), is a tripartite team with each side being represented by not more than 6 persons who are delegated on the one hand by the government (the Minister of Economic Affairs and the Minister of Education delegate two members each, the Minister of Social and Family Affairs and the Minister of Finance delegate one member each) and on the other hand by the employer and employee organizations (nevertheless they are still officially assigned by the Minister of Economic Affairs).

The employment policy programs are financed from the Labor Market Fund (see Table 10).

Labor Force Development by the Ministry of Social and Family Affairs

The central budget earmarks funding for the purposes for labor force development in the chapter of the Ministry of Social and Family Affairs, too.

Unfortunately their is no publicized information on how amounts which are not awarded through a competitive tendering process are allocated.

The Joint Labor Force Development Program of the Ministry of Social and Family Affairs and the Ministry of Agriculture and Rural Development

Here three programs are run in conjunction with PHARE:

1. A program supporting the social and labor market (re)integration of multiply disadvantaged youths.
2. A program supporting the labor market (re)integration of the gypsy minority.
3. A program supporting the labor market (re)integration of the disabled.

Community Works Program

The Ministry of Social and Family Affairs has invited proposals in 2002 for the improvement of the living conditions and social position of the long-term unemployed and regular recipients of welfare benefits; for the organization of development, renovation and maintenance (with special regard to infrastructure) projects which contribute to the reduction of unemployment; and for encouraging the performance of municipality functions which contribute to the development of the underdeveloped areas.

Proposals may be submitted by municipalities and their associations in conjunction with ethnic minority self-governments.

A prerequisite is that at least an average of 100 statistically registered unemployed are to be provided with full time employment, as compared with the statistical headcount of the month preceding the commencement of the community works program. The support is non-reimbursable and is financed from a budget of HUF 970 million which is specially committed for this purpose within the community works program appropriation of the Ministry of Social and Family Affairs. The maximum amount that may be awarded to a proposal is HUF 60 million.

5.4.4 Financial Resources Outside the Central Budget

Student Loan

Student loans are available from September 2001 to Hungarian citizens who are younger than 35 years of age and are students of an accredited tertiary level vocational training institution, or tertiary level accredited undergraduate or graduate level basic training or supplementary basic training, whether or not they are required to pay a tuition fee.

The sums available through the loan, which can be applied for in forms that are available at post offices, amount to HUF 10,000, HUF 15,000, or HUF 21,000, and the government would like to increase these sums from 2003.

The loan is provided for five months in each semester. The Postabank (the financial institution that has been assigned to manage student loans) disbursed the first amount in October 2001 and disburses it on a monthly basis; however in the event of scholarships abroad the amounts for a whole semester can be requested in advance in a lump sum.

The interest rate varies. In accordance with a government decision announced in August 2001, it is 9.5 percent in the academic years 2001-2002 and 2002-2003.

The repayment of the loan commences when the person ceases be a student or the entitlements to the loan terminates. Repayment is made in sums that correspond to 6 percent of the borrower’s gross income liable to personal income tax. With the approval of the government, DHK (Student Loan Center) may increase the percentage rate each calendar year by 1 percent, however it may not exceed 8percent.

6. EVALUATION

The tabulated evaluation along five predefined criteria uses a scale of five grades where *grade 1* indicates that a given criterion is hardly met, whereas *grade 5* indicates that a given criterion is fully met.

6.1 Concentration

Under the criterion of concentration, it was analyzed whether the given funds are provided in a coordinated way and focus sufficiently on the tasks to be implemented or are entirely scattered across the various sectors.

Programs where the evening out of regional anomalies plays no part at all scored *1 point*.

6.2 Programming

Programs which are fully in synch with a development strategy that encompasses several sectors or are part of such strategy have scored *5 points*.

Programs that are to a high extent in synch with a development strategy encompassing several sectors have scored *4 points*.

Programs where the development strategy encompassing several sectors carries approximately the same weight as the given development project have scored *3 points*.

Programs where compatibility with the development strategy encompassing several sectors is only traceable have scored *2 points*.

Programs which are incompatible with a strategy encompassing several sectors have scored only *1 point*.

6.3 Partnership

Under the criterion of partnership we analyze the scope of government coordination, whether all the stakeholders have been sufficiently involved in the decision-making process, and whether there is central dominance or the decisions are based on consensus.

Programs and funds where the stakeholders are fully involved and the decisions on the allocation of funds are not automatic score *5 points*.

Funds where partnership is mostly visible but is not always perceivable in the decision-making processes score *4 points*.

Funds where partnership in support issues is only formal, and one of the parties outweighs the others score *3 points*.

Funds where there is only some semblance of cooperation score *2 points*.

Programs where decisions are quite openly made without any cooperation score *1 point*.

6.4 Additionality

5 points were scored by programs that may usually be implemented with 50 percent or more matching funds.

4 points were scored by programs where substantial matching funds are required.

3 points were scored by programs where more than nominal matching funds are contributed.

2 points were scored by programs where there is only a nominal matching fund requirement.

1 point was scored by programs where no matching funds are required.

6.5 Transparency

5 points were scored by programs where the terms and conditions as well as the procedure preceding the award of the grant are absolutely transparent, and information

a.)on the size of the program,

b.) the amounts of committed vs. uncommitted funds at any point of time during the program,

c.) and the list of grant recipients is clear and available to all interested parties.

4 points were scored by programs which have less transparent or fairly complicated and intricate components in their terms and conditions, and proposal evaluation and monitoring processes.

3 points are scored by programs which are fairly transparent and can be kept track of all right, but contain elements in the terms and conditions, the awarding procedures or in the use of funds that are uncertain and resist the scrutiny of the public.

2 points are scored when the terms and conditions are somewhat transparent when the program is launched, but as the program progresses they become increasingly nebulous, ending up in complete intransparency at the end of the day.

1 point is scored when it is only the outline of the program that is perceivable, but the terms and conditions for the submission of proposals and the proposal evaluation procedures are only known by the initiated.

Table10. Evaluation

Support	Concentration	Programming	Partnership	Additionality	Transparency
PHARE program	5	5	1	4	3
SAPARD program	2	5	4	5	3
ISPA program	2	5	2	5	3
Targeted and addressed grants	4	2	3	3	4
Rural development targeted appropriation	5	4	4	5	3
Economic development targeted appropriation	3	4	2	5	2
Regional economic development targeted appropriation	3	4	2	5	2
Targeted appropriation for small and medium businesses	3	4	2	5	2
Targeted appropriation for tourism	3	3	2	5	2
Environment Fund targeted components	3	2	3	5	2
Water management targeted appropriation	3	3	3	5	3
Targeted appropriation for road maintenance and development	2	2	3	5	4
Tax relief	4	4	2	1	5
Phare programs for human resource development	5	5	1	4	3
Labor Market Fund	4	4	4	3	4
Labor force development under the Ministry of Social and Family Affairs -Phare	4	5	3	5	2
Labor force development under the Ministry of Social and Family Affairs - community works program	4	4	2	1	4
Student loan	1	1	1	1	2

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Investing in Regional Development: Policies and Practices in Latvia

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1. Introduction

While presently applying for EU membership, Latvia is also in the process of formulating its own regional development policy. In developing such policy, it would be a mistake for an applicant country to look exclusively at matters, which are of concern to the EU or, to promote a perspective, which uncritically adopts the approach taken by the European Commission to regional development. However, it is an indisputable fact that over the next few years at least, the bulk of funding for regional development in Latvia is likely to be disbursed by the European Commission. For this reason, it is important that Latvian institutions are aware of the main EU sources of assistance for regional development and of the mechanisms for obtaining such assistance, as well as the main principles guiding it.

The Commission has emphasized that it is particularly important for applicant countries to ensure that plans do not focus exclusively on regional or sectorial issues but take full account of the national and international context. The various national plans will therefore need to start from an understanding of the ability of the applicant country concerned to meet the three types of conditions for accession to the EU. This means that account will need to be taken of the National Program for European Integration, the National Budget and sectorial programs, including the Public Investment Program. Regional development strategies can only be fully effective when they are developed with an appreciation of their wider context.

Nonetheless, while activity across all of the national territory of applicant countries will be eligible for assistance, the National Plans will be expected to include a description of regional disparities and development gaps and, where appropriate, proposals to respond to these. Such proposals may either be treated by a specific measure or measures or horizontally (that is to say, across a number of sectorial measures). This raises a number of questions, such as whether different regions should be eligible for different types or simply different levels of assistance or whether all disadvantaged regions need to receive assistance during the same programming period. However, perhaps the most fundamental questions to be resolved relate to the definition and delineation of regions.

In defining regions for development policy purposes, political identity, administrative capacity and information availability all need to be considered, despite that the primary criterion should be economic. Political identity is important not least because the effective and efficient delivery of regional assistance depends on a level of local partnership and commitment. Administrative capacity must be capable of either already delivering the types of policy being proposed or being developed to that level. Information must be available on the condition of the region. It also must be feasible to obtain further information in order to monitor the implementation, and evaluate the effect of policy. This point raises the issue of the degree to which regions as delineated for the purposes of collecting statistics (time-series data on standard economic variables such as employment, investment etc.) need to be congruent with regions as delineated for development policy purposes.

Thus this report will provide the information on activities in the field of capital investments and regional development to now, the planned future arrangements and how they follow the main principles of EU funding.

2. Local and Regional Government Structure and Competencies in the Field of Regional and Local Development, Investment Attraction

The citizens of the Republic of Latvia implement state public power through the highest decision-making institution Parliament (*Saeima*), self-governments elected through direct elections, and district councils formed by self-governments. According to the Constitution of the Republic of Latvia (*Satversme*), Parliament establishes the highest state executive power - approving the Cabinet of Ministers offered by the Prime Minister and ministries.

Based on the law On Self-governments, adopted by the Parliament in 1994, there are two forms of self-governments: local and district (regional) governments. Local self-government is local executive authority – council - acting as a representative body elected by citizens. Through the Council's established institutions and entities, it ensures performance of functions assigned by the laws, as well as tasks assigned based on the principles defined in this law, by the Cabinet of Ministers, and local self-government's voluntary initiatives, taking into consideration interests of the state and residents of the respective administrative territory.

The district council is indirectly elected as these councils consist of all the mayors from local governments within the borders of the district.

Local self-governments are split into towns, pagasts (rural self-governments) and novads self-governments (amalgamated territories), which have equal functions and rights. District self-governments have different functions from local governments. Governments of the Republic cities perform both - local or district government's functions and have the rights granted to both.

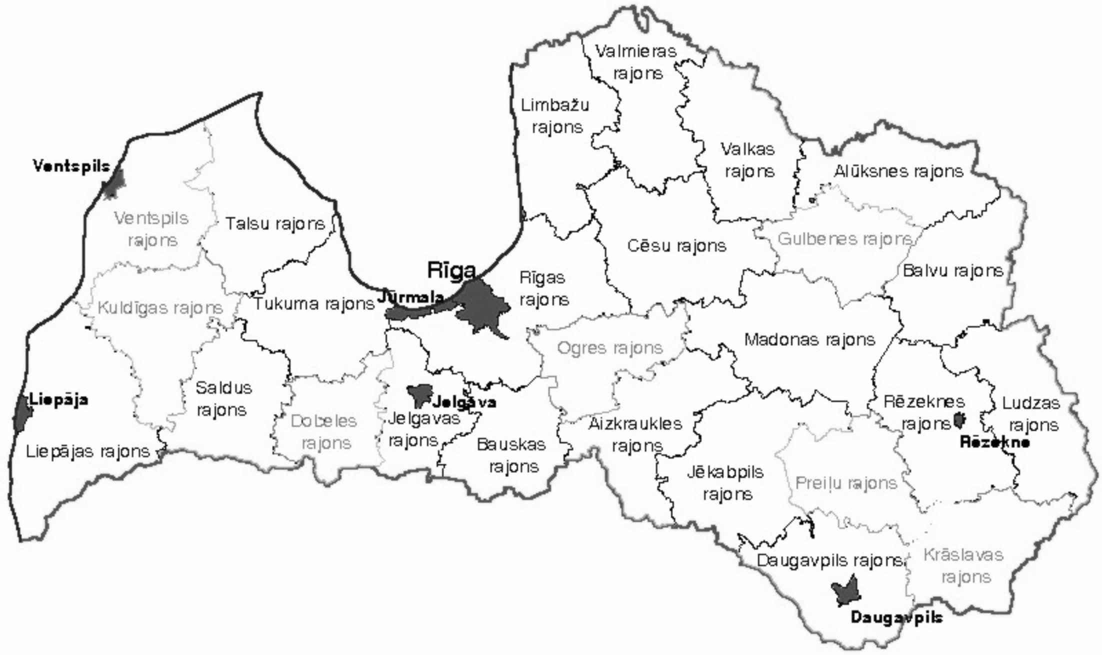
Table 2.1 Structure of Self-Governments in Latvia (01.01.2002.)

Type of Self-Governments	Number
Second tier (regional level)	
District self-governments	26
Republic cities	7
First tier (local level)	
Republic cities	7
Towns	62
Rural self-governments (pagasts)	469
Amalgamated territories (novads)	10

A more detailed description of administrative subdivision could be as follows:

- A *pagast* is a self-government, usually having a village as its center and a rural territory surrounding it;
- A town is a self-government, whose territory coincides with the town limits;
- A town with a rural territory is a self-government having a provincial town as its center and a rural territory surrounding it;
- A district center is usually the biggest town in the district in terms of population.
- Amalgamated territories (*novads*) newly established self-governments are the result of amalgamating town and *pagasts* or *pagasts* and *pagasts* (see the following description of territorial reform.).

Picture 2.1. Territorial Subdivision of Latvia Into 26 Districts



Administrative-Territorial Reform

On October 21, 1998, *Saeima* accepted the law On Administrative Territorial Reform.

The overall aim of administrative territorial reform is to establish administrative territories, which will be able to advance economically and to provide good quality service to inhabitants.

The reform shall be implemented by way of unifying (amalgamation) pagasts into larger units with larger area, more population, higher revenue and lower administration costs (now 10-18 percent of the budget is spent on administration). New administrative units should be historically, economically and geographically coherent with suitable infrastructure for performance of municipal functions. The Law indicates that there shall be two levels of municipalities in Latvia established until 2004:

- Level 1 - Local (*pagast*) self-governments as a result of unification of *pagasts*, towns and cities,
- Level 2 - District self-governments and municipalities of republic cities.

The latest proposal presented by the government for discussion is for 102 lower level local governments at the end of the reform. This decision has to be passed by the Parliament.

The principle of self-governance is not defined by the Constitution. Discussions on inclusion of a separate chapter on self-governments in the Constitution have continued for ten years.

Latvia has passed the law, On Administrative Territorial Reform, which stipulates that local self-governments may voluntarily amalgamate, or establish cooperation unions by 2004.

For many years, there have also been discussions held on regional reform that would result in five or nine regions replacing the existing 26 districts (rajons). The leading political parties do not share a unified opinion on the status of regional administrations (whether elected self-governments or state appointed), their functions and financial basis. The issue is most likely to be tackled after the elections of the Parliament in October 2002.

The recent local elections were held on March 11, 2001 and more than 0.8 million inhabitants comprising 61.98 percent of the total electorate consisting of 1.3 million voters, participated.

During the process of negotiation, the Minister of Finance or his authorized person represents the Cabinet of Ministers, but self-governments – by the self-governments' public organization, established in accordance with the requirements set in the clause 96 of the law "On Self-governments" (the Union of Local and Regional Governments of Latvia). The results of negotiations are formulated in the form of protocol. Protocol of negotiations reflecting consensus or disagreements is attached to the draft project of respective state budget, which then is submitted by the Cabinet of Ministers to the Parliament.

Latvia has been established one of the most effective systems of intergovernmental negotiations in Europe.

According to the subsidiary principle, the towns, rural and amalgamated self-governments should perform as many tasks as possible because they constitute the lowest local government level.

In the first years after independence, many tasks were decentralized to the local governments.

The current law "On Self-Governments" stipulates seventeen permanent functions for rural and amalgamated self-governments as well as towns, and only four permanent functions for districts:

- To participate in the provision of a civil defense system;
- To organize the public transport services;
- To ensure the self-governmental representation in regional health-care institutions;
- To organize further education for pedagogic staff and organize methodical educational work.

The permanent functions for districts are very limited, but most of the districts perform a considerable number of voluntary tasks and, to some extent, support the weaker local governments with the implementation of their tasks.

As mentioned previously, governments of Republic cities perform both local and district governments' functions.

- All permanent functions influence regional and local development:
- Organization of municipal services for the inhabitants (water supply and sewage networks, heat supply, collection and disposal of household waste, collection, disposal and treatment of sewage);
- Maintenance of its administrative territory and provision for the sanitary tidiness of it (construction, reconstruction and maintenance of streets, roads and squares; provision of lighting for streets, squares and other public territories; control of the collection and disposal of industrial waste; anti-flood measures; formation and maintenance of cemeteries and burial places for dead animals);
- Control of public forest and water source use, if the laws do not provide otherwise;
- Provision of education (securing the rights of inhabitants for primary and general secondary education; securing places for pre-school and school children at educational institutions; organizational and financial assistance to out-of-school educational establishments and educational assistance establishments etc.);
- Maintenance of culture and support for the maintenance of traditional culture values and development of creative work of the people (organizational and financial assistance to cultural establishments and activities, support for the maintenance of cultural monuments etc.);

- Assurance of primary healthcare for the inhabitants as well as promotion of a wholesome way of life;
- Assurance of social care (social care to poor families and socially unprotected persons and provision of pensioners with places in old people homes, provision for orphans and children rejected by parents with places in educational institutions, provision of homeless persons with asylums etc.);
- Managing guardianship, trusteeship and adoption issues;
- Assistance to inhabitants in dealing with accommodation issues;
- Promotion of entrepreneurial activity in its administrative territory, managing the control of unemployment;
- Issuance of permits and licenses for entrepreneurial activities, if provided by law;
- Provision for public order, to fight heavy drinking and profligacy;
- Estimation of construction procedure in accordance with the plan of the corresponding administrative territory;
- Management of the construction of the corresponding territory;
- Registration of civil acts;
- Collection and provision of information necessary for state statistics;
- Organization of elections of court assessors and responsibility for the organization of Council elections;
- Participation in provision of civil defense system;
- Organization of public transport services;
- Assurance of self-governmental representation in regional health-care institutions;
- Organization of further education for pedagogic staff and organization of methodical educational work.

The rights of self-government to regulate provision of public services are provided for in the law On Self-Governments, which determines that self-governments have the ability to fix charges for:

- Rent (lease) of self-government dwellings and not-living fund, which is closely connected with the covering of expenditures for the maintenance of apartment houses, as well as to fix a maximum rent charge in the territory of the self-government;
- Use of self-government water main and sewage;
- Heating supplied by self-government;
- Collection of household waste;
- Other services provided by self-government institutions and enterprises.

One of the main problems of Latvian governments' policy is how to increase the attraction of capital investment at the local level.

Although self-governments in Latvia are responsible for investments, these represent a small share in total self-government expenditures: 13.6 percent in 1998, 14.0 percent in 1999, 16.7 percent in 2000 and 12.5 percent in 2001.

3. Regional Development Policy Issues

3.1 SPATIAL PLANNING SYSTEM IN LATVIA

A new stage in development planning began in Latvia after the restoration of independence. Present legislation on spatial planning sets out four levels of development plans:

- A national plan for the whole country;
- Regional plans that may be administrative district development plans or plans based on other criteria defining a distinct region,
- Local town and *pagast* development plans,
- Plans for specific locations.

The plans of each level are prepared, taking into account the development programs, guidelines and regulations accepted at higher level.

In addition to the spatial planning, sector planning is performed by central level authorities. Each line ministry is responsible for preparing its sector policy guidelines, programs and development concepts. When preparing the first National Development Plan of Latvia, an attempt was made to integrate all these concepts into the National Development Plan. Unfortunately, the capacity for preparation of the National Development Plan appeared to be weak and failed to create an integrated strategic assessment of the current situation. This was reflected in development priorities that were broadly based and which seemingly reflected simply the priorities submitted by Ministries.

The new Spatial Planning Law will define the framework for spatial planning and involvement of institutions in spatial planning, from national to local level. The Saeima approved the draft law in the second reading on February 28, 2002 and it is being prepared now for the third (final) reading. The new law will substitute for the Territorial Development Planning Law.

3.2 REGIONAL DEVELOPMENT POLICY FRAMEWORK

The policy document that lays down the objectives of regional development policy of Latvia is the Latvian Regional Development Concept, adopted by the Cabinet of Ministers on December 3, 1996 (Protocol No 58, Paragraph 30).

A Working Group, which was chaired by the Ministry of Environmental Protection and Regional Development (MEPRD) developed the Concept. The Working Group was also comprised of representatives of the Ministry of Economy, the Latvian Institute of Agrarian Economics, the Latvian University, the Union of Local and Regional Self-Governments, the Latvian Development Agency, the Enterprise Support Centers and the Latvian Technology Center.

The objectives of the Concept of Regional Development Policy of Latvia are:

- To create preconditions for ensuring a favorable and equal living environment, living and working conditions in all regions of Latvia;
- To decrease and avert unfavorable regional disparities and support preservation of favorable disparities;
- To ensure sustainable development in Latvia and its regions, bringing economic activity in line with preservation and enhancement of cultural and natural heritage;

- To create preconditions for integration of Latvia into the EU and the processes of its regional development;

The Concept of Regional Development Policy of Latvia provides the legal basis for regional development policy.

A comparison of legislation created in the Concept and the situation regarding these legislative acts in the period 1996 – 2001 is set out in the following table.

Provided in the Concept.	Prepared and Passed by Parliament / Cabinet of Ministers.
The law on development planning must be drafted and passed	The Law on Territory Development Planning is in force since October 30, 1998.
The law on administrative territorial reform of local authorities must be drafted and passed	The Law on Administrative - Territorial Reform is in force since October 30, 1998.
The law on special support regions must be drafted and passed.	• Formally the implementation of the assisted regions policy in 1996 with the presentation of the Concept on the Regional Economic Development to the Prime Minister. • The Law on Assisted Regions was adopted in January 1997. In May 1997 the Law was formally endorsed by the Parliament
The directives of the Cabinet of Ministers that regulate the designation of special support regions and define the procedure for elaboration, implementation and monitoring of support measure must be drafted and passed. (The deprived regions were selected and approved on the level of lower level municipalities. Author)	• Cabinet of Ministers regulation No 263 from July 1997 "On order for Assigning the Status of Assisted Territory". • Instruction of the Ministry of Economy No 175 from 15 August 1997 "On Processing of Data Necessary for Determination of Assisted Regions " which establishes the Working Group for determining the potential assisted regions and provides an instruction for defining potential disadvantaged areas. Instruction of the Ministry of Economy No 235 from 17 October 1997 "On Order for Evaluation of the Development Programs Submitted by Potential Assisted Areas" with attached "Regulations of the Inter-Ministerial Working Group for Evaluation of the Development Programs of Potential Assisted Areas"
The regulations on the Regional Development Fund must be drafted and approved.	• Cabinet of Ministers Regulations No 290 from 5 August 1997 "On Regional Fund". • Cabinet of Ministers Regulations No 223 from 16 June 1998 "On Order for Requesting, Assigning and Disbursing the Money from Regional Fund and Control over Utilization of Assigned Funding"; Instruction of the Ministry of Economy No 132 (part 1) from 6 July 1998 "On Evaluation of Project Proposals (submitted for funding from Regional Fund)"; • Instruction of the Ministry of Economy No 132 from 6 July 1998 (part 2) "On Utilisation of the Regional Fund Resources for Partial or Full Interest Rate Subsidies"; • Instruction of the Ministry of Economy No 143 from 24 July 1998 "On Establishment of Consultative Commission of Regional Fund" • Rules of the non-profit state limited liability company "development of Regions" — regulations of the cabinet of ministers NR 45 from 10 February 1998". Instruction of the Ministry of Economy NR 136 of 13 July 1998 " On Investments of the regional Fund in the Statute Capital of Enterprises" • "Rules of the non-profit status limited liability company "Development of regions" — Regulations of the Cabinet of Ministers Nr.45 from February 10 1998. • Instruction of the Ministry of Economy NR. 136 of July 13 1998 "On Investments of the regional Fund in the Statute Capital of Enterprises"
The regulations on the Regional Development Board of Latvia must be drafted and approved.	Cabinet of Ministers Regulations No 264 from 29 July 1997 "On Regional Development Council"
The standard regulations on Regional Development Boards must be drafted and approved.	Cabinet of Ministers Regulations No 387 from 25 November 1997 "On Order for Establishment of Development Councils and Local Development Funds in Assisted Regions"
Budget formation principles and tax legislation, increasing the responsibility and scope of functions of local authorities, as well as increasing their financial	

independence, must be developed.	

A further legislative act in relation to local government also should be noted. The amendment to the Law on Local Governments passed by Parliament, has been in force since October 14, 1998, and states:

"Local governments can establish common institutions on the base of mutual agreement for the implementation of common tasks. Such institutions work on the base of the statutes approved by the corresponding council (councils). The statutes provide the competence of the commonly established institution of local governments, the procedure of financing and monitoring, as well as other matters of this common institution."

This amendment allowed development councils of planning regions already founded to establish development agencies or funds for practical implementation of development strategies in these territories.

On March 21, 2002, the Parliament adopted the "Regional Development Law" which defines the general system for regional policy in the country. It also defines several provisions linked to the planning and coordination of EU Structural Funds:

- Defines the hierarchy of planning documents for regional development, including the National Development Plan (NDP) as a national regional policy-planning document for a seven-year period, which consequently will be used as a reference document in elaboration of the Development Plan (Draft Single Programming Document);
- Provides the institutional framework for coordination of regional policy issues between national and regional levels (institutionalization of the planning regions), these mechanisms will be used to ensure necessary national–regional–local partnership for management of EU Structural Funds in Latvia;
- Includes provisions on defining the specially assisted territories in the country and on the possibility of supporting these territories via the Regional Fund (potentially this could be one specific measure to be included into the Single Programming Document). Regional Development Law replaces the existing law, On Assisted Regions.

Alongside the Concept a number of initiatives had been undertaken to address the question of regional development, such as:

- Subsidies for territorial planning and drafting development projects-Ministry of Environmental Protection and Regional Development (MEPRD);
- The Rural Development Program, (MEPRD);
- The SME Development Program, Ministry of Economy;
- The Latvian Guarantee Agency, Ministry of Economy;
- PHARE support to the Diversification of the Rural Economy, Ministry of Agriculture;
- The SPP Urban Pilot Project, MEPRD;
- The SPP Rural Pilot Project, Ministry of Agriculture;
- The Integrated Development Program for *Latgale*, MEPRD;
- The Integrated Coastal Zone Management Plan (ICZM), MEPRD;
- The Coastal Investment Strategy, MEPRD;
- Border Area Policy, MEPRD;

(See section 4.2 for a more detailed description of the programs)

As seen in the list above, the tasks related to regional development had been shared by several ministries, which led to a lack of clear objectives associated with the actions undertaken by various institutions and little coordination among the policies and strategies despite the existence of numerous inter-ministerial working groups. There were several attempts during the recent three years to establish better coordination mechanism between the ministries sharing responsibility on regional development as well as possible establishment of a new institution – Regional Development Ministry (as it was strongly required by the EU Commission in line with introduction of EU pre-structural fund assistance in Latvia). (See the new institutional set-up for regional development below).

It should be noted that despite the existence of the Concept of Regional Development Policy of Latvia, there is considerable uncertainty about the nature and scale of regional disparities, even though the statistical office and the responsible ministries have undertaken much work in identifying problem regions. There is little evidence of any monitoring and evaluation process to determine the effectiveness of the strategies and little coordination among the policies and strategies which do exist within the various ministries and are targeted to regional development issues, despite the existence of numerous inter-ministerial working groups. This results in the lack of effective regional development policy or programs in Latvia.

The next attempt to have coherent approach in designing regional development policy was preparation of the National Development Plan, which despite having the technically correct approach in designing the plan (partnership principle following, see the chapter below) and having the right purpose and objectives, still just acknowledges the problems but does not show significant commitment in addressing regional development issues.

3.3 NATIONAL DEVELOPMENT PLAN WITH A VIEW ON REGIONAL DEVELOPMENT

The first version of Latvia's National Development Plan (NDP) was prepared in October 1999. The revision of it started in January 2000 under the leadership of the Minister for Special Assignment for Cooperation with International Financial Agencies.

The Institutions involved in the planning and programming process of the National Development Plan (NDP) are the following:

SMSACIFA (operational from 1999):

- Has an overall responsibility for preparation of NDP and programming documents (presently PHARE ESC projects, SPD in future);
- Heads the programming process, reports to the Government of progress, submits the final document to the Cabinet of Ministers and the European Commission;
- Performs the coordination function between sectorial institutions (ministries) and partners at sub-national level (planning regions, municipalities);
- Carries out the consultations with partners in society;
- Ensures publicity and transparency of programming process.

Ministry of Finance:

- Co-ordinates preparation of state budget with planning and programming;
- Assesses the compliance of priorities and measures proposed under NDP and programming documents with provisions of state budget and sound management of public funds.

Sectorial ministries (participate in the NDP preparation process from 1999):

- Ensure coordination of sectorial policies and NDP;
- Provide information on sector policy analysis, priorities and measures to be included in NDP.

Planning regions (Participate in the NDP preparation process from 2000. The legal status and role of the planning regions will be defined more precisely after the adoption of the new "Law on Regional Development"):

- Ensure coordination between development planning in particular region and preparation of NDP;
- Provide information on situation in the region and specific priorities of the planning region;
- Represent the opinion of municipalities.

To ensure both broad social involvement and preparation of a qualitative document, the NDP Steering Group, the NDP Unit and the NDP Experts Group were established.

By the decision of the Latvian Government on April 4, 2000, The NDP Steering Group was established. It is responsible for overall management of the NDP preparation process. The Minister of Special Assignment to Co-operation with International Financial Agencies chairs the Steering Group. The group consists of senior officials of the Ministries and heads of Regional Development Agencies from five planning regions.

At the same time, The NDP Unit was also formed. It is headed by a representative from the SMSACIFA and is responsible for the practical preparation of the NDP. The NDP Unit involves representatives from the same institutions as represented in the NDP Steering Group. The Unit is also responsible for a regular dissemination and exchange of information with partner institutions.

In 2001, The NDP Expert Group was established by Decree of the Prime minister involving fifteen high level professionals from both public and private institutions. The Minister for Special Assignment for Cooperation with International Financial Agencies leads the group.

To strengthen the status and the overall integrity of the National Development Plan (NDP), and to achieve better coordination of the preparation process, the Latvian Government passed a special decree concerning the NDP (On the Preparation of the National Development Plan) on March 7, 2000. This decree contained important measures to ensure the development of the National Development Plan and provided the institutions responsible for the National Development Plan with a mandate and the resources to do so. The Decree also confirmed the status of the National Development Plan as a medium term strategic planning document to analyze social and economic conditions, and to determine priorities and measures for its development over the next six years.

The Draft of the Law on Regional Development submitted to the Government in June 2001, has also prescribed the place of the NDP in the hierarchy of the strategic planning documents. At the moment, NDP has three basic objectives.

Firstly, the purpose of the NDP is to promote socio-economic development of the whole country over the six following years establishing realistic objectives and priorities for achieving these objectives, as well as determining practical and systemic directions of activity for achieving the objectives and earmarking required funds.

Secondly, development of the NDP makes an effort to incorporate innovative ideas from different development documents of the country.

Thirdly, allocation of public investments will also be performed based upon the document. The NDP will also serve as the foundation for granting financial assistance to Latvia from EU pre-accession. It is significant to emphasize that the Single Programming Document will be prepared on the basis of the NDP right before joining the European Union.

Based upon the above-mentioned, the NDP Management Group has approved five strategic objectives that are in line with the present socio-economic situation in Latvia and are directed towards facilitation of Latvia's economic growth:

- To promote sustainable development of Latvia, raising the welfare of each individual;
- To promote regional development, reducing and eliminating the adverse regional disparities and developing the favorable diversities;
- To promote growth and competitiveness of educated and cultured individuals;
- To promote integration into the European Union;
- To develop democracy and to improve the public administration system.

Related to these priorities of national development have been identified as the most significant for promotion of future development of the country:

- Diversification of economy and orientation to products with high added value;
- Creation of a favorable environment for development of entrepreneurial activities and attraction of financial resources;
- Adaptation of professional qualifications of labor force to labor market requirements;
- Development of economic infrastructure;
- Increasing effectiveness of public administration;
- Integration of society;
- Development of social infrastructure;
- Balanced and sustainable development of regions.

On February 27, 2001, the Cabinet of Ministers approved the NDP Strategic Memorandum (SM) as the background document for further preparation of the NDP. The SM gives a concentrated and analytical insight into the most significant tendencies of the present development of the country and its development outlook in the future. Concrete directions of activity have been highlighted in order to provide implementation of these priorities.

On the basis of the analysis of the current situation in the country, it can be concluded that an effective and qualitative implementation of the above priorities will facilitate the development and strengthening of the state, so as to ensure welfare and personal growth of every member of the society and democratic functioning of public administration institutions. This, in turn, will foster economic growth and increase the competitiveness of the country among the countries of the European Union.

Based upon the priorities and areas of activity formulated in the Strategic Memorandum, a plan of measures essential to national development for implementation of the priorities will be developed during further stages of preparation of the NDP. For the purposes of the NDP preparation, a new methodology was prepared based on the guidelines used for the preparation of the Single programming Document in the EU Member countries.

A number of documents were produced during the implementation of the PHARE project Technical Assistance to the Special Preparatory Program for the Structural Funds (SPP/TA) that are available at the Secretariat. These included:

Sectorial analysis of the following:

- Financial Services – which included recommendations on how to develop this sector in Latvia;
- Forestry Sector – including strategy for future development;
- Transportation;
- Communications;
- Transit services;
- Environmental protection and sustainable development;
- Tourism;
- Information technology;

- Social integration.

It also includes:

- Methodology paper including timetable for the production of and NDP using experience of EU countries;
- Macro economic analysis of the Latvian economy in a format suitable for incorporation in the NDP;
- Social and economic review of Green Field Pulp Mill;
- Latvia's development perspectives – an overview;
- Interlinked financial and macroeconomic development;
- SWOT analyses of the current social and economic situation;
- Identification of development priorities and priority measures;
- Statement of key development problems in Latvia.

In addition to this, a package of sector analysis was made during the preparation of the NDP Strategic Memorandum. The National Development Plan was approved in the Government in autumn 2001.

By the decision of the Government on March 7, 2000, Secretariat of the Minister for Special Assignment for Cooperation with International Financial Agencies and was appointed to be responsible for the preparation of the National Development Plan. After institutional restructuring and integration of the structures of the Secretariat into the Ministry of Finance that took place at the beginning of 2002, responsibilities of the Secretariat were taken over by the Regional Policy and Planning Directorate, a subordinated body of the Ministry of Finance and Ministry of Finance itself. This decision also prescribes coordination and drafting of the Development Plan, in 2002, and Single Programming Document and Program Complement.

During the preparation of the NDP, a database of more than 150 institutions and experts was created that were involved in the process of the preparation of the Plan in different stages (formal and informal consultations, workshops, meetings, writing of the relevant information for the NDP). The database includes professional non-governmental and governmental institutions, trade unions and employer confederations, banks, entrepreneurial and professional associations, whose subjects were covered by the NDP.

Preparation of the NDP, however, showed that broader and deeper involvement of the partners is necessary. Therefore, during the preparation stage of the DP, a list of institutions can also be applied to by involving the respective institution in the work of a certain working group or providing exchange of information and consultations on a daily basis. Involvement of social-economic partners at every level of the DP preparation is expected, beginning from the decision making (NGO's center, Trade Unions, Employer Confederation etc., main institutions would be involved in NDP Management group) to the writing and editing of the plan in working groups and think-tanks.

The proposed institutional scheme of preparation of the Development Plan allows the highest possible flexibility in constructing working groups. This empowers the Unit to seek advice from specialists in each specific industry of the economy.

Due to this flexible scheme, the partnership principle will be brought to life in the process, which lacked it severely in the past. Each of the working groups will be allowed time to be constructed. During this period, the line-ministries and other members of the Unit as well as those of existing working groups will disseminate the information on the task of the group and invite experts.

The less formal type of partnership in the form of public discussions is envisioned on conclusion of each structural part of the Plan.

On the other hand, the Development Plan Unit and its core think-tank group will keep full control over the process.

3.4 REGIONALIZATION ISSUES

Planning Regions of Latvia and Their Relation To NUTS Classification

In regard to compliance of the territorial organization to EU structural policy, the Latvian government has decided to treat the whole territory of Latvia as a single region corresponding to NUTS level II. This is, however, an issue for negotiations between the EU Commission and the Latvian government from final approval. It is further split up into five regions, which correspond to NUTS level III. These generally correspond to the five planning regions that have been set up recently in Riga, Latgale, Zemgale, Vidzeme and Kurzeme. The exact borders of the five planning regions still need to be clarified.

Latvia's settling structure can be described as the monocentric model, as economic activities are much higher in the central part of the country and transit ports than in the rest of Latvia. Approximately half of Latvia's population lives in the Riga region.

Latvia's administrative division represents 33 regional units: 26 districts and 7 cities of national importance, which, along with local government functions, also perform the statutory functions of regional authorities.

In accordance with the law, Administrative Territorial Reform, an administrative and territorial reform is presently being implemented in Latvia. It deals with the amalgamation of lower-level local governments. There is still ongoing debate in Latvia on the establishment of bigger administrative regions. The recent versions discussed and commented by ministries were five or nine administrative regions. The decision regarding regional reform will most likely be passed after the next Parliament elections in autumn 2002.

In accordance with the Resolution of the Cabinet of Ministers of April 4, 2000, by January 1, 2001, five planning regions had to be set up in Latvia: the Kurzeme, Latgale, Riga, Vidzeme and Zemgale regions. Formation of the planning regions took place in a democratic "bottom-up" manner as local governments set them up. The planning regions established Regional Development Agencies to deal with regional development and investment attraction. They have been involved in preparation of National Development Fund and project proposals for the PHARE Economic and Social Cohesion (ESC). Two of the planning regions (Latgale and Zemgale) received PHARE 2000 ESC assistance of EUR10 million for capacity building and productive investments. At present, neither planning regions nor Regional Development Agencies are involved in management of PHARE ESC programs in Latvia. Regarding the two other EU support programs (ISPA and SAPARD), central government institutions program and manage them. Concerned ISPA planning regions may be involved in preparing project proposals (as any other local or regional body). Regarding the SAPARD program, local governments have the representation in local management councils for the SAPARD program in the regions.

In the context of economic analyses, Latvia is divided into five statistical regions (NUTS III): the Kurzeme, Latgale, Vidzeme, Zemgale and Riga region. The borders of statistical regions do not completely coincide with the borders of planning regions.

It should be noted that the statistical five regions of NUTS are not the same planning regions. According to the new Regional Development Law (passed by the Parliament on March 21, 2002), the Government has to prepare the proposal to set the territories of planning regions by September 1, 2002. Until planning regions are set according to this law, the existing planning regions voluntarily established by local governments based on the law On Territorial Development implements the function of planning regions.

The Five Statistical Regions of NUTS (Riga Region, Kurzeme, Zemgale, Vidzeme, Latgale)

The Central Statistical Bureau aggregates regional data by statistical regions that are identified in the protocol (March 30, 1999) signed by the Ministry of Environment Protection and Regional Development and the Central Statistical Bureau. Such division of regions is referred to as the NUTS level III in accordance with the agreement made between the Statistical Office of the European Communities (Eurostat and the Central Statistical Bureau) and in line with the NUTS (Nomenclature of Territorial Units for Statistics) principles.

Before signing the mentioned agreement, the list of various regional constituencies were presented to EUROSTAT to see which are more appropriate for NUTS levels (the existing administrative division, constituencies for Parliamentary elections, regional court constituencies etc.). The final decision was as follows:

- NUTS I and II are the same for the whole country of Latvia;
- NUTS III are the constituencies for parliamentary elections (in reality, when the collection of statistical data was started, some slight changes were made regarding the Riga region borders);
- NUTS 4 are twenty-six administrative regions (*rajons*) and seven Republic cities;
- NUTS 5 are all lower level municipalities – 557 units altogether.

The Five Planning Regions

Since these planning regions were voluntarily set up by the municipalities themselves from bottom up, they followed more historic, geographical, social, economic and other criteria so their borders do not coincide precisely with the statistical regions. They are the Riga region, the Baltic Sea Side region (in reality covering Kurzeme region), Zemgale, Vidzeme and Latgale. All planning regions have Councils as decision-making bodies, which are chaired by rotation principle. All municipalities signed the agreement on establishment that the planning region is owner of the Development Agency (see the note on the law which allows several local governments to establish one enterprise or institution to serve their functions) and have assigned certain amount of money for the agency to be run.

According to the position paper of the Republic of Latvia regarding Chapter 21: Regional Policy and Coordination of Structural Instruments the following agreement has been reached between the European Commission and the Latvian Government:

- As for NUTS level II, it will remain unchanged, according to the decision of the Government on December 5, 2000 to treat the whole of national territory as corresponding to the single NUTS level II region.
- It is proposed that during the course of 2002 and 2003 existing (notified to the Commission by 1999) NUTS III division of the country will be used. The official letter confirming the proposal of a NUTS classification was sent to the European Commission (Eurostat) on April 25, 2002 (see Annex No.1).
- In accordance with the recently adopted Regional Development Law (March 21, 2002), the Cabinet of Ministers has to confirm the territories of the five planning regions before October 15, 2002. It is intended that after re-definition of the boundaries of the five planning regions, they should correspond to the NUTS III division of the country.

- During the course of 2003, after the territories of the planning regions are fixed there will be a transition period where both the existing NUTS III division will be used and five planning regions will start to function in the borders defined by the Cabinet of Ministers. If the discrepancies between territories of planning regions and NUTS III division exist at that stage, Latvia will propose revision of NUTS III division of the territory of the country to the EC (Eurostat).
- Finally. by 2004 the NUTS III division of the territory of the country should correspond to the boundaries of the five planning regions and all statistical information will be collected in accordance with this division.

Regional Development Agencies

By April 2000, the regional development agencies of Latgale, Zemgale, Vidzeme and the Riga region have been established as regional development planning and implementing institutions at the local level.

The aim of the agencies is to concentrate the internal potential of the region and to attract external potential, to ensure sustainable growth of economy and increase of the competitiveness of the region. The criteria for formation of regional development agencies is:

- The agency is the executive institution, which, in practice, implements regional development policy in accordance with the national development policy principles;
- Its legal status is that of a non-profit limited liability company;
- Financial provisions – equity belongs to the municipalities forming the region.

The main functions of the agency are:

- Regional development planning, elaboration of sustainable regional development plans on behalf of self-governments and national authorities;
- Coordination of services for development and implementation of projects;
- Development of information and a data base of regional development;
- Support for existing and newly created enterprises;
- Attraction of foreign and domestic investment, etc.

Picture 3.1. Map of Planning Regions

Picture 3.2. Map of Statistical Regions

Debate on Regional Reform

The division of Latvia into five statistical regions corresponding to Nuts level III created a lot of discussions and speculations regarding regional reform. There were many representatives from the central government institutions and politicians, who announced that the regional reform has to be implemented according to this NUTS level III since that is what is required by the European Union. Local and regional governments opposed, citing that there are no such requirements regarding administrative structures. There were some attempts made to complete the regional reform and the ministries were required to present their best proposals for re-division of the regional structures of the ministries (each ministry has its own set up of regional structures which differ substantially one from another). There were two suggestions discussed at the last stage of reform, planning five or nine regions, as well as possible organization of these regions (directly elected or not, combined with state institutions or not etc.). There are no further developments regarding regional reform. This issue will most likely only be on the government agenda after the next Parliamentary election in autumn 2002.

3.5 REGIONAL DISPARITIES

The proposal to formulate a regional development strategy for Latvia implies that regional disparities exist within Latvia that, if left unchecked, would increase rather than decrease and thus would inhibit the possibility of balanced development within the national territory as a whole. Testing this hypothesis is difficult since data at a regional level, as opposed to at the level of *pagasti* or *rajoni*, is very limited. That is not to say that regional disparities do not exist, but rather to suggest that it is important to demonstrate in an objective fashion if they do exist and at what level.

Part of the problem is that there is no unanimity within the Latvian administration as to what exactly constitutes a “region” for the purposes of regional development. This is in part because there is no clear view of what exactly regional development is and what its objective is or should be. Much work is currently being done to formulate proposals on administrative boundaries in the ongoing local government reform process but this is being carried out without any specific focus on regional disparities. Instead, it is about identifying administrative boundaries based, we understand, primarily upon economic characteristics of adjoining *pagasti*.

In our view, the rationale for adopting a regional development approach is that it promotes economic and social cohesion by providing a mechanism by which resources (whether local, regional, national or international) can be allocated on the basis of identified and agreed priorities. Whether those priorities are about reducing regional disparities (the 'equity' approach) or about the best allocation of limited resources on a straightforward cost-benefit approach at the national level (the 'efficiency' approach) is a separate question.

Within Latvia, it is clear that the initially overriding issue is likely to be one of reducing regional disparities, even if those disparities have not yet been clearly articulated. For this purpose, regions can be identified in one of two ways. First, as specific problem areas (*cf.* Objective 1, 2 of the EU Structural Funds), which merit the special attention of national sectorial policies. Second, as sub-divisions of the national territory which provide a framework for the allocation of resources through the preparation by the region of regional development plans within the overall context of a national development strategy. The former may be thought of as a 'top down' approach; the latter as 'bottom up'.

The Latvian authorities have started to address the identification of problem areas but have not as yet sub-divided the national territory into regions (often referred to as 'macro regions') for development planning purposes. This paper attempts to set out some of the issues involved in both of these approaches.

The rationale for identifying problem regions must be that, once identified, these regions can benefit from policies directed at solving the specific problems faced by each region. There is no shortage of statistics available at the *pagast* level and the Annual Statistical Yearbook offers a mass of data covering a wide range of indicators. Using some of this data, and other sources, the Ministry of Environmental Protection and Regional Development has published a booklet of over thirty maps, which show the variation at *pagast* level of a selection of socio-economic and other indicators. With over 500 *pagasti,* it is difficult to draw any meaningful conclusions in terms of the implications for policy formulation from data presented in this way and we are not aware of any attempts having been made to do so. What is needed, therefore, is to present the data in a manner which allows trends to be identified.

In this context, work initiated by the Ministry of Economy has sought to identify the major types of problems which regions in Latvia face and these have been grouped into several types as follows.

- Regions which are backward in terms of socio-economic development;
- Regions which have problems with agricultural development;
- Regions that are depressed;
- Regions which are along the borders of the state, especially those territories in the far East of Latvia;
- Regions which lie along the seashore;
- The Riga metropolis;
- Regions with transportation corridors such as Via Baltica and the West-East transport corridor;
- The region which is influenced by the radar station at Skrunda;
- The Liv Shore, *et al.*

Given such a comprehensive list, it is not immediately apparent just what parts of Latvia, if any, are considered problem-free. Furthermore, the means by which such regions might be defined were not specified, nor was the nature of the problem in some cases.

With the limited resources available to address all these problem regions, the decision was made to identify those deserving special assistance because of suffering long term negative economic and/or social development trends. The law On Assisted Regions is the enabling legislation, which determines the general procedure for granting the status of assisted region and for promoting its economic development.

The power to grant, and withdraw the status of assisted region rests with the Cabinet of Ministers. The decisions are to be based upon statistical data, experts' estimates of the regions' development prospects and other indices, but the Law is not specific about how these data, estimates and other indices are to be determined. Collectively, the assisted regions should not constitute more than fifteen percent of the national population. The Law provides that the status of assisted regions should be reconsidered every three years but gives no guidance on how such reconsideration is to be carried out.

By Regulation, the Cabinet of Ministers identified the statistical indicators (see Annex) to be used for determining a list of disadvantaged regions from which the Cabinet of Ministers would make the final selection. However, the Regulations give no specific instructions on how these indicators were to be used to determine the proposed list. The Ministry of Economy subsequently prepared 'Instructions for defining potential disadvantaged areas (methodology)'. These instructions propose a weighted ranking methodology to be applied to two territorial groups: districts and Republic cities; and *pagasti* (rural municipality) and towns/cities (including Republic cities).

Following the identification of a proposed list of regions eligible for designation as 'assisted regions', the Ministry of Economy invited these regions to prepare what are referred to as regional development programs, the main emphasis of which must be the development of entrepreneurship in the region. In the current round, 112 local and district authorities qualified for disadvantaged area status but only 81 of them (75 *pagasti*, the Republic city of Jelgava, and five *rajoni* in the Latgale region) responded to the invitation of the Ministry of Economy to submit development plans. Of these, 65 were given positive assessment. A second submission of development plans resulted in a further 25 regions gaining 'assisted region' status.

Turning to the concept of 'macro regions', Latvia is presently subdivided into 26 *rajoni* or districts, which, together with the seven Republic cities, constitute the tier of local government immediately below the national level. Both in terms of the concept of 'assisted regions' discussed above and in terms of local development initiatives, it is perfectly feasible to operate at this sort of level. Witness, for example, the twenty-six county divisions within Ireland, (which is approximately the same size as Latvia), and the success of the European Union LEADER program which operates at this sort of level throughout the EU. Funding can then be provided from a central fund such as the Regional Development Fund to support local development initiatives.

There is a consensus within the EU, however, that in order to have a more coherent and integrated policy for the development of regions that are lagging behind, a larger territorial unit should be used. The convention is that regions corresponding to the NUTS III category provide a suitable basis for regional development planning. While no final decision on the boundaries of the NUTS III regions within Latvia has been taken, it seems likely that they could correspond, more or less, to the regional sub-divisions of Vidzeme, Kurzeme, Zemgale and Latgale together with the metropolitan area of Riga. While these regional sub-divisions have no legal status there seems to be a general agreement within Latvia that they represent traditional, historic divisions, even if their actual boundaries have varied slightly over time.

There are two difficulties in using such macro regions in Latvia. First, there are no administrative functions exercised at such a regional level, so the implementation of a regional development policy would require the establishment of some implementing institutions at that level. Second, statistical data is not aggregated at the regional level (except for those data sought by EUROSTAT) so it is difficult to get any picture of the extent of disparities in regions, as opposed to districts.

3.5.1 General Characterization of Planning Regions

Table 3.1 Area of Planning Regions

Region	Area Km^2	% of the total territory
Riga region	10,352.6	16.0
Kurzeme	13,600.8	21.1
Latgale	14,547.2	22.5
Vidzeme	15,346.4	23.8
Zemgale	10,741.6	16.6
Total	64,588.6	100.0

Resource data of the CSB

Although Latvia is a comparatively small European country, each of the five planning regions have specific characteristics of territories. There is a considerable amount of forest resources in both the Kurzeme and Vidzeme regions. That is important factor, both for development of the wood processing industry, and for attraction of foreign tourists, as there are very few similar natural landscapes in Europe. Latgale region has thirty-four percent of the total amount of Latvian water reservoirs. Kurzeme is home to 45.3 percent of the whole country's fishponds.

There are no major differences between regions as regarding the percentage of land used for agricultural purposes. Although Latgale has the highest percentage of land used for agricultural purposes, it has to be acknowledged that the most favorable situation in this field is in Zemgale, as soils there are very fertile, which promotes development of agriculture. Brushwood is not included in the area of land used for agricultural purposes. In this respect, Latgale has to be mentioned as their brushwood accounts for 2.94 percent of the territory (35.7 percent of the total amount of brushwood).

The lands of the planning regions are characterized by a large number of specially protected nature territories (SPNT). This creates certain limitations on industrial and business activities in these territories. Different minerals (limestone, sand, gravel, quartz sand, quaternary clay, turf, sapropel gypsite, dolomite) that can be used in the economy are found in all regions of Latvia.

There are no big disproportions observed in the density of motor roads among the regions. The biggest length of motor roads (including forest roads) per 100 km^2 is in Riga and Latgale regions (7.452 and 7.442 km/100 km^2 respectively). The most sparse road network is in Vidzeme, where there are on average 6.6 km of motor roads per 100 km^2. The center of the railway network is located in Riga. Due to this, the network of Riga and neighboring regions is denser. The average length of railway per 100 km^2 is bigger (4,487) in Riga than in Latgale, Kurzeme and Vidzeme regions (3,978, 3,305 and 3,061 km/100 km^2 respectively). These indicators do not include streets and railways in the densely populated areas such as the capital and cities of the country.

3.5.2 Qualitative and Quantitative Characterization of the Population

Although in the terms of area all Latvian planning regions are similar, the number of permanent inhabitants registered is very different. Half of the population lives in Riga region (see Table 3), which has the smallest area, but only one-tenth of the population of the country live in the region with the greatest area (Vidzeme).

Table 3.2. Quantitative and Qualitative Indicators of Population at the Beginning of 2000

	Riga region	Kurzeme	Latgale	Vidzeme	Zemgale	Total
Number of inhabitants	1,116,454	320,601	381,912	255,569	291,595	2,366,131
% of total population	47.2	13.6	16.1	10.8	12.3	100.0
Number of inhabitants/km^2	111.4	24.2	26.6	16.8	27.6	37.5
Percentage of urban population, % of total number of population in the region	85.3	62.9	58.3	41.7	49.7	68.90
Percentage of the economically active inhabitants, % of total number of inhabitants in the region	52.6	45.7	49.2	43.7	45.8	49.3
Level of education **	51.1	41.8	45.0	43.3	42.2	47.0

Resource: data of the CSB

*Qualitative – from the perspective of human resources (how much (indicated by percentage) and what quality (level of education) of potential labor resources are available in the region)

** Level of education – percentage of inhabitants with secondary or higher education in the total number of population

The percentage of the economically active population indicates the labor force potential. In this respect the situation in Riga region is the most favorable, as this indicator is over fifty. It is mostly determined by Riga city, where almost sixty percent of all inhabitants fall into the category of economically active population, whereas in the rest of the territory the indicators fluctuate around forty percent. This can be explained by migration within the region. A similar situation is observed in Latgale, where both cities of the republic have the highest percentage of economically active inhabitants in the country (in Daugavpils -60 percent, in Rezekne -64 percent), but in the region in general, it is lower than fifty percent.

The level of education of the country's population is closely linked with the location of the higher education institutions in the regions and their closeness to the populated areas. Taking into account these criteria, the level of education compared to other regions is higher in the Riga region where fifty-three percent of all inhabitants have either secondary or higher education. In other regions the average rate of forty percent is found.

3.5.3 General Characterization of Employment and Labor Market

The situation of average unemployment in the regions is significantly different. The lowest level of unemployment is registered in the Riga region, but the highest - in Latgale. According to the data of the official statistics, in 1998 the level of unemployment in Riga region was 4.1 percent, but in 2000 it was 4.9 percent. This indicates that the natural level of unemployment was only slightly exceeded. Vidzeme region had the second lowest indicator after Riga with 9.0 percent and it is followed by Kurzeme region with an unemployment rate of 10.2 percent in 2000 and Zemgale with 10.5 percent. The level of unemployment in Latgale is constantly high at 15.7 percent in 1998, 17.8 percent in 1999 and 16.8 percent in 2000. However, the unemployment level is even higher and exceeds the limit of 20 percent in Latgale regions due to the high number of companies that terminated their activities after the fall of the USSR and the slow development of small and medium size enterprises.

3.5.4 Characterization of Business Activity

At the end of 2000, 26,067 or sixty-six percent of the entire country's companies were located in the Riga region with 83.3 percent of them or 54 percent of the total number of companies registered in the country located in Riga itself. Ten percent of the all economically active companies of the country were located in Kurzeme region, and nine percent in the Latgale and Vidzeme regions.

The smallest number of the registered companies is in Zemgale with seven percent of the country's total number, but looking at the number of companies per 1,000 inhabitants, the smallest number of companies is in Latgale - only eight companies.

3.5.5 Gross Domestic Product (GDP)

*Table 3.3. Gross Domestic Product by Region**

GDP	Year	Riga region	Kurzeme	Latgale	Vidzeme	Zemgale	Total
Thousands of Ls (in actual prices)	1996	1,653,567	423,125	289,566	192,638	268,799	2,827,695
	1997	1,968,157	510,626	323,111	217,446	253,357	3,272,697
	1998	2,309,074	489,246	303,983	223,433	260,165	3,585,901
% of the total							
	1996	58.5	15.0	10.2	6.8	9.5	100.0
	1997	60.1	15.6	9.9	6.6	7.7	100.0
	1998	64.4	13.6	8.5	6.2	7.3	100.0
Per capita							
Ls (in actual prices)	1996	1,423.3	1,270.4	725.8	734.3	896.9	1,151.4
	1997	1,713.1	1,550.8	817.7	834.0	852.3	1,346.1
	1998	2,030.3	1,501.9	777.3	862.2	881.6	1,488.9
% of the EU average	1998	38.2	28.2	14.6	16.2	16.6	28.0

*Resource: data of the CSB

The increase of contribution of Riga region to the GDP is related to the fact that from 1996 until 1998 the biggest increase was observed here, namely, 39.6 percent. The significant increase was also observed in Vidzeme and Kurzeme regions (16.0 percent and 15.6 percent respectively), which allows to hope that in the near future the volume of products manufactured and services provided in Vidzeme will considerably increase and that Kurzeme still has a very high economic potential and will provide a big contribution to the country's economy in the future.

Situation in Latgale and especially Zemgale is different; where from 1996 until 1998 the increase of the nominal GDP was 5.0 percent and -3,2 percent respectively. Therefore taking into account the inflation it can be said for sure that the volume of manufacturing and provision of services of those regions during this period has not increased or has even decreased (in Zemgale

3.6 INSTITUTIONAL SET UP FOR MANAGEMENT OF NATIONAL REGIONAL POLICY, EU STRUCTURAL FUNDS AND COHESION FUND

As it was described in the previous chapters, several ministries had shared the planning, management and monitoring of regional policy in Latvia:

- Ministry of Environment and Regional Development (planning issues);
- Ministry of Economy (Regional Fund and technical assistance for Regional Development Board);
- Ministry of Agriculture (rural development);
- Ministry of Welfare (employment);
- Secretariat of the Minister for Special Assignment for Co-operation with International Financial Agencies (planning and management of PHARE program and monitoring of ISPA program, NDP preparation, Preparation to structural fund implementation);

These failed to establish an effective coordination mechanism or a separate ministry.

In a decision of December 2000, the government acknowledged the need to ensure coordination among sectors, as well as between national and regional levels, and to establish an effective institution with an adequate capacity and mandate to deal with planning, programming and management of cohesion policy in the country. It also decided to reallocate resources from a number of institutions dealing with issues of regional policy and include them in the secretariat of the Minister for Special Assignment for Co-operation with International Financial Agencies. But in July 2001, the government then decided to entrust the Ministry of Finance with the task of managing the Structural Funds in the future. According to the decision, the Ministry of Finance will be responsible for coordination of the national budgetary policy with planning of EU structural Fund programs. In December 2001, the secretariat of the Minister for Special Assignment for Co-operation with International Financial Agencies was integrated with its responsibilities into the Ministry of Finance. Now there are two ministers within the Ministry of Finance.

Under the supervision of the Ministry of Finance and under the responsibility of the Minister for Special Assignment for Co-operation with International Financial Agencies there are the following two departments and one newly established institution:

Departments subordinate to the vice state secretary of the Ministry of Finance:

- Department of Foreign assistance Coordination (bilateral, WB etc.)
- Department of structural instruments (PHARE, ISPA and SAPARD steering committee
- Institution subordinate to the Minister for Special Assignment for Co-operation with International Financial Agencies
- Department of Regional Policy and Planning
- Dealing with Economic and social cohesion, national regional policy, NDP, Regional Fund

3.6.1 Institutions involved in the management of the EU Structural Funds and their responsibilities[1].

[1] Guidelines on management, monitoring, evaluation and control system of the EU structural instruments

The Managing Authority

In compliance with the EC Regulation 1260/1999, the Managing Authority is the institution nominated by the Member State to be responsible for managing the European Union Structural Funds.

According to decision of the Cabinet of Ministers of February 5, 2002 the Ministry of Finance is designated the Managing Authority.

Functions of the Managing Authority:

- To take responsibility of managing the Structural Funds, as well as of the efficient implementation of assistance and its compliance with relevant tasks;
- In co-operation with the European Commission to work out the Development Plan as a draft Single Programming Document and its Program Complement as well as to represent the Member State in negotiations with the European Commission on the Single Programming Document;
- To take responsibility for implementation of the Program Complement;
- To organize and to manage the job of the Monitoring Committee as well as to ensure efficient and independent evaluation of the implementation of the Single Programming Document;
- To take responsibility for the preparation and submission of the annual report, the mid-term and the closing report on the implementation of the Structural Funds intervention to the European Commission;
- To ensure conformity with the Community policies;
- To create the system of static and financial data;
- To co-ordinate the co-financing from the State budget;
- To ensure the coherence of financed operations, especially reinforcing internal audit according to the sound financial management principles and react to any request to implement the correcting measures;
- To ensure the compliance with the publicity and information requirements.

The Paying Authority

According to the Council Regulation (EC) No 1260/1999 of June21, 1999, the Paying Authority is one or more national, regional or local authorities or bodies designated by the Member State for the purposes of providing financial management of European Commission support. According to the Decision of the Cabinet of Ministers of February 5, 2002, the Ministry of Finance is designated to perform the functions of the Paying Authority. The State Treasury will fulfill the functions of the Paying Authority.

The Partner Institutions

In order to ensure the most effective and appropriate utilization of the funds, it is necessary to set up a management scheme providing adequate flexibility to evaluate the specific needs of different sectors and territories. The separate Partner Institution has therefore been designated to work with each financial instrument (fund).

The Partner Institutions of the Managing Authority are the Ministry of Agriculture (European Agricultural Guidance and Guarantee Fund and the Financial Instrument for Fisheries Guidance), the Ministry of Welfare (European Social Fund) and the Regional Policy and Planning Directorate (European Regional Development Fund).

The Managing Authority shall collaborate with line ministries and planning regions, taking into account the measures financed by the Structural Funds and those that may also concern the competence of the relevant ministry or planning region.

The Managing Authority delegates the following tasks to the Partner Institution:

- To co-ordinate the preparatory measures for work with the funds of competence of the institution until the time of accession to the EU;
- To participate in the elaboration of the Development Plan and its Program Complement within its competence;
- To ensure of the necessary information and publicity on measures financed by the fund under the responsibility of the institution and the criteria and procedures of selection of projects;
- To organize the selection of the projects in accordance with the criteria developed;
- To ensure the monitoring of the measures financed by the fund under the responsibility of the institution;
- To ensure that the funds under the responsibility of the institution are operating correctly;
- In accordance with the provisions of the Managing Authority to maintain the system of financial and statistical information on the achievements of the measures financed by the fund under the responsibility of the institution;
- To verify and to confirm the payment requests;
- To ensure the relevant system of financial management and accountancy;
- To participate in preparation of the annual report on implementation of the Structural Funds intervention.

The Intermediate Bodies

Intermediate Body may be public or private structures or services that act under the guidance of the Managing Authority and the Paying Authority or on behalf of those in order to accomplish tasks as regards the Final Beneficiaries or institutions or enterprises carrying out the activities within the Structural Funds intervention.

The Managing Authority, the Paying Authority and the relevant Partner Institution, responsible for the management of the funds agree to appoint the Intermediate Body bodies. The Managing Authority informs the European Commission of Intermediate Bodies foreseen before the preparation of the Development Plan is concluded.

Upon the agreement with the corresponding Partner Institution, the Managing Authority delegates the following tasks to the Intermediate Body or bodies:

- to verify the measures financed;
- to provide the verifiable source documents;
- to verify the payment requests;
- to verify the conformity of the activities financed with the provisions of the Community;
- to provide the relevant accounting system;
- to perform the functions of the project selection secretariat ;
- to provide the distribution of information and publicity on the financed projects and measures;
- to provide the financial and statistical information and perform the monitoring of the physical and financial progress of project implementation;

- to submit verified and certified payment requests to the Partner Institutions.

Draft Proposal for Division of the Funds and Intermediate Bodies

Funds	Intermediate Bodies
European Regional Development Fund	Implementing Body of the Ministry of Finance; Regional Development Fund Development Agencies of Planning Regions
European Social Fund	State Employment Service, Latvian Development Agency, Social Integration Fund, Professional Educational Development Agency, Development Agencies of Planning Regions
European Agricultural Guidance and Guarantee Fund	Rural Support Service
Financial Instrument for Fisheries Guidance	Rural Support Service

Determined Intermediate Bodies are identified on the basis of the present administrative capacity.

The final distribution of functions related to the Structural Funds may be conceived at the stage of elaboration of the Program Complement defining the introductory measures pursuing to the identified sums and envisaged amounts of the project.

Monitoring Committee

According to the Article 35 of the Council Regulation 1260/1999, the Monitoring Committee monitors the elaboration and implementation of the Single Programming Document. The Monitoring Committee is established upon the agreement with the Managing Authority. The Monitoring Committee is established not later than three months after the positive decision of the European Commission on drawing the financial assistance.

The Managing Authority elaborates the procedures to be approved by the Monitoring Committee. The Managing Authority organizes and provides administration to the functioning of the Monitoring Committee.

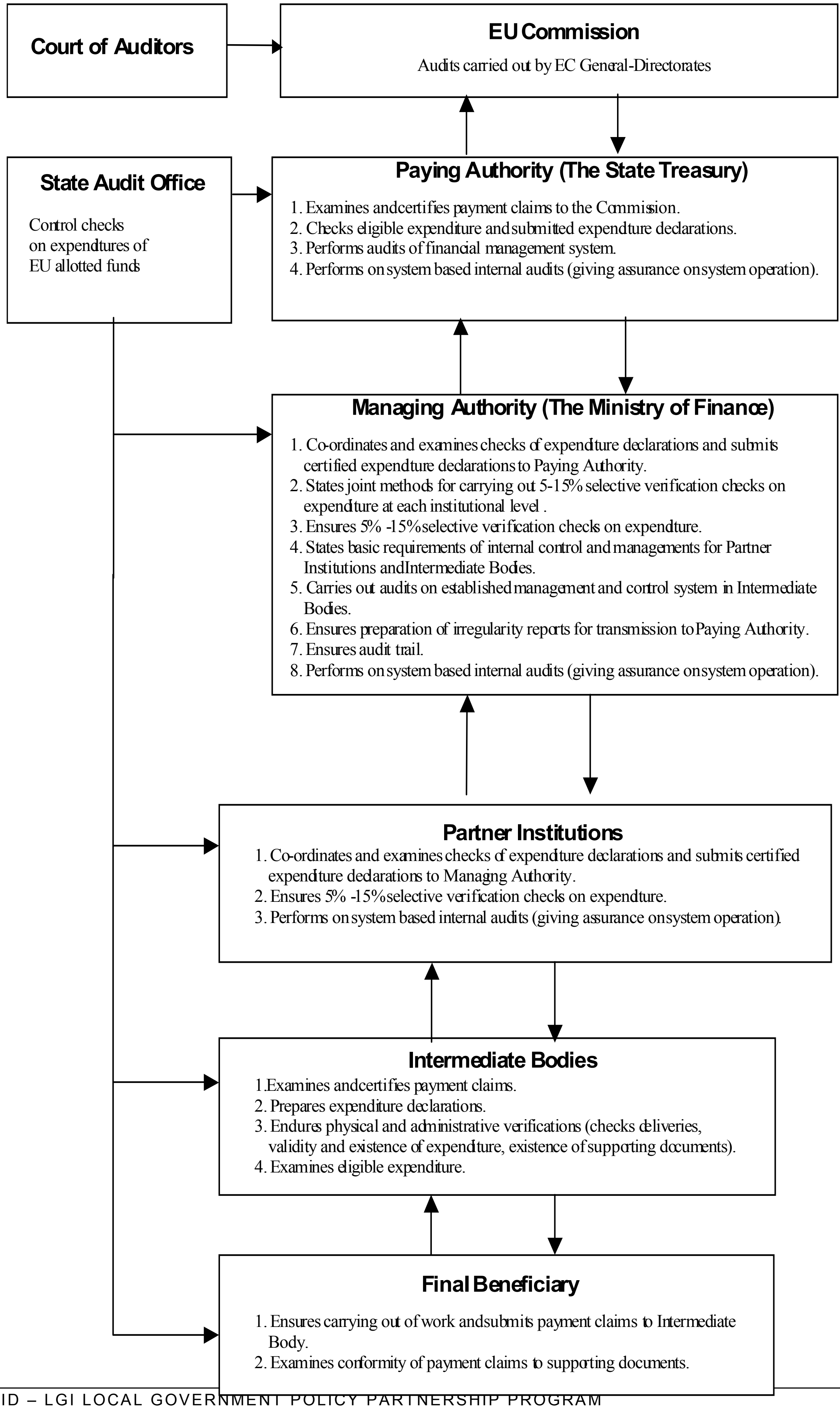
The Monitoring Committee carries out the following tasks:

- To confirm or to correct the Program Complement, including physical and financial indicators that have been elaborated to monitor the assistance provided;
- To examine and to confirm criteria for the selection of activities (projects) within each measure;
- To revise periodically the progress attained by implementation of specific aims of assistance;
- To review the aims reached in relation to each financed measure and to carry out mid-term evaluations;
- To review and to confirm annual and final reports before submission to the European Commission;
- To review and to confirm propositions regarding the amendments of financial granting as to the decision of the European Commission;
- If necessary, it may suggest to the Managing Authority to make changes or checks to provide for (1) the achievement of the objectives of the EU Structural Funds set out in Article 1 of the Regulation 1260/1999, (2) the improvement of the managing system, including the financial management.

The Monitoring Committee consists of the representatives of the following institutions and co-operation partners:
Ministry of Finance (the representatives of both the Managing Authority and the Paying Authority);

- Ministry of Welfare;
- Ministry of Agriculture;
- Ministry of Economics;
- Ministry of Education and Science;
- Ministry of Transport;
- Ministry of Environmental Protection and Regional Development;
- Social partners;
- 5 Planning regions;
- Union of Latvian Municipalities;
- European Commission (as an observer)
- Various International Financial Institutions (as observers)

Picture 3.3. Financial Management and the Control System for Structural Funds



4. The Overall Characteristics of Capital Investment Financing in the Country

4.1 GENERAL STATUS OF INVESTMENTS AND SAVINGS

The most important goal at the present stage of development of the Latvian economy is to encourage sustainable growth, which is linked, largely, to the speedy introduction of contemporary, modern means of production and technologies corresponding to the latest achievements of research. All this requires investment. Investments as creators of productive capacity increase the fixed capital (produced assets). The technological and branch structure of investments predetermines rational and efficient use of resources in the state.

In Latvia, the same as in other East European transition economies, in the last decade there were two phases in the dynamics of public investments in the real sector: in the first years of restructuring of the economy (from 1990 to 1994) investment decreased faster than GDP, going down annually by more than 30 percent. The real sector in 1994 received five times less investment than in 1990. After stabilization of economy and improvement of the entrepreneurial environment, the positive dynamic of the investing process was reinstated. In the period between 1995 and 2000 annual growth of investment reached 18 percent. Because of this, the share of expenditures of gross fixed capital formation in GDP went up from 15.1 percent in 1995 to 24.6 percent in 2000. Positive tendencies in the investing process were retained also in 2001.

In the first half of 2001, almost 14 percent of the aggregate demand consisted of expenditure of gross fixed capital formation that went up by 9.6 percent in comparison with the same time in the preceding year.

*Table 4.1.Gross Fixed Capital Formation**

	1996-2000 (Average Per Year)	1999	2000	First Half of 2001 Against First Half of 2000
Real growth (%)				
GDP	4.7	1.1	6.6	8.8
Gross capital formation	8.3	-8.7	-1.2	16.2
– Gross fixed capital formation	17.7	-4.0	10.8	9.6
Percentage against GDP				
Gross capital formation	25.1	27.0	27.1	24.5
– Gross fixed capital formation	23.2	25.1	24.6	21.2
– Changes in inventories	1.9	1.9	2.5	3.3

*Resource: Economic development of Latvia. Report, 2001

4.1.1 Investment by Types of Property

From 1995 to 2000, rapid growth of investments was mainly ensured by investments in the private sector. These went up in the average by 49 percent per year exceeding almost four times investment in the public sector[2]. Investment in the private sector in 2000 equaled 58 percent of total investment, which is 26 percentage points more than in 1995. In nine months of 2001, the private sector received by 15 percent more investment than in the same time of the preceding period, including investments owned by residents which grew by 34 percent

[2] Public sector comprises all state owned companies and organizations; local government companies and organizations, statutory unions with a state or municipal-owned part in the fixed capital in the amount of 50% and more; public and religious organizations and their companies, budgetary institutions.

and those owned by non-residents – by 16 percent. On October 1, 2001, the non-resident share in the total equity capital of Latvian enterprises equaled 26 percent. Investment in the public sector went up by 3 percent and totaled 42 percent of all non-financial investments.

Despite modest overall growth rates of investment, in the public sector they tend to be more stable. Thus, for example, investment in the public sector continued growing during the slow-down periods of economic activity linked with the Russian financial crisis, declining, at the same time, in the private sector. This demonstrates the stabilizing effect of public investment. In contrast, investments in the private sector are more subject to cyclical fluctuations of economy.

Sector structure of investment in nine months of 2001, retained tendencies of the previous years; i.e. the majority of investment was made in the services sector.

Analysis of technological structure of non-financial investment shows that the structure since 1997 is dominated by technological machinery and equipment, yet this share decreases every year. In nine months of 2001, 31 percent of all non-financial investment was attributed to technological machinery and equipment, which is two percentage points less than in the preceding year and seven percentage points less than in 1997.

Analysis of investment dynamics, sectors and structures, highlights the following tendencies in the investment process in Latvia:

- Dynamic growth of investment;
- Distribution of investment by sectors is not supportive to economic growth potential in tradable sectors. This means that investment is not much focused on increase of competitiveness of Latvian economy;
- Inefficient technological structure of investments and, consequently, low return on investment;
- Concentration of investment in Riga and other port cities, deepening the already existing regional disproportion;

4.1.2 Public Investments

To increase the level of produced assets and at the same time to promote improvement of their structure, it is necessary to establish economic, legal and administrative incentives to ensure proper environment for business and investment.

Public investment is the part of gross fixed capital formation, which is funded by the state budget, budgets of local governments and special budget resources. These investments are mainly going to the creation and modernization of infrastructure and formation of produced assets in the social sphere.

According to the data of the national accounts, public investments in Latvia between 1996 and 2000 constituted an average of 3.8 percent of the GDP and 16.8 percent of gross fixed capital formation, lagging behind the level in the majority of East European countries with transition economies in the same time. However, it must be noted that investment level in Latvia in the last years has gone up and has come close to the level of other countries in transition.

Since 1995, the Public Investment Program (PIP) is regularly developed in Latvia with the aim to consolidate use of budget resources for capital investment and to raise their efficiency. However, PIP does not include all investment made by the state but only approximately 55 percent.

Table 4.2. Public Investment In Latvia

	1996	1997	1998	1999	2000*	Average per year 1996 – 2000
Million LVL						
Public investment** Including: PIP***	72.1 33.2	96.9 67.6	152.3 80.3	184.8* 107.7	191.0 90.6	139.4 75.9
Percentage of GDP						
Public investment Including: PIP***	2.5 1.2	3.0 2.1	4.2 2.2	4.7 2.7	4.4 2.1	3.8 2.1

Resource: Economic development of Latvia Report, 2001
*Estimation.
**Gross fixed capital formation in the sector of public administration (S13). Source: National Accounts of Latvia.
***Part of PIP funded from the budget.

The remaining amount of public investment is financed from state special budgets. Special budgets are funded from specially earmarked revenues (according to legislation) disbursed for special purposes. There are a number of special funds, including State Motor Road Fund, Railway Infrastructure Fund, Port Development Fund, Environment Protection Fund, Health Fund, Social Insurance Fund, Regional Development Fund, etc. (see section 4.2)

PIP also does not include projects funded by local government budgets if they do not contain central government budget co-financing or state credit guarantees. Total PIP funding also includes resources that lie outside government budgets, such as private company resources, state budget loans, other loans, etc.

Table 4.3. The Share of Investment Expenditure, Million LVL

	1998	1999	2000
Total budget expenditure	1,572.2	1,745.1	1,743.3
International Investments	92.1	113.0	100.9
In percentage	6	6	6
Total state budget expenditure	1,168.9	1,317.2	1,290.7
International Investments	60.6	69.7	49.3
In percentage	5	5	4
Self-government budget expenditure	403.3	427.9	452.6
International Investments	31.5	43.3	51.6
In percentage	8	10	11

Recourse: date of the State Treasure

The share of investment expenditure in the total budget expenditure has remained relatively stable at six percent. The situation is different for state and self-government budgets. The share in the state budget is 4-5 percent and 8-11 percent in self-government budget.

4.1.3 Dynamics of the Public Investment Program

The total funds of PIP from the central government basic budget, special budget, and loans, with or without state guarantees and other sources (grants, private resources of project executors) have gone up from 1.2 percent in 1995 to 3.3 percent of GDP in 2000. However, in 2001 the investment from the mentioned sources of financing went down to 2.9 percent of the GDP. Investment from the state basic budget in 2001 was 33.5 percent greater than in 2000.

The priority sectors within PIP, in terms of total invested amounts, are transportation, energy and environmental protection. The priority projects financed from the central government basic budget belong to sectors of internal affairs, defense and education.

4.1.4 Public Investment Program for 2001

According to the law on the budget amendment, PIP in 2001 will be financed from: the central government basic – LVL 53 million; the special budget – LVL 4.4 million; loans – LVL 52.1 million and LVL 28 million from other sources.

Generally, the Public Investment Program for 2001 has retained the primary aim of investing as identified in the previous years, that is, energy, transportation and environment protection constituting 63 percent of total planned investment.

Table 4.4 PIP From All Sources of Financing by Sectors

	1999		2000		2001 (plan)		2002 (plan)	
	Million LVL	share, %	Million LVL	share, %	Million LVL	share, %	Million LVL	share, %
PIP	137.7	100	141.1	100	137.5	100	129.0	100
of which:								
Transportation	49.0	35.6	37.6	26.6	39.7	28.9	38.2	29.6
Environment	25.8	18.7	34.8	24.7	32.1	23.3	24.7	19.1
Energy	12.6	9.2	29.2	20.7	14.8	10.8	4.2	3.3
Welfare	12.7	9.2	10.5	7.4	11.1	8.1	14.9	11.6
Education and science	5.3	3.9	9.8	6.9	14.4	10.5	12.2	9.5
Finances	10.7	7.8	5.1	3.6	5.1	3.7	5.5	4.3
Internal affairs	9.6	7.0	5.1	3.6	11.6	8.4	13.2	10.2
Defense	3.4	2.4	2.4	1.7	3.2	2.3	9.6	7.4
Justice	2.5	1.8	2.2	1.6	2.3	1.7	2.9	2.2
Agriculture	2.2	1.6	1.8	1.3	1.6	1.2	2.0	1.6
Culture	2.0	1.5	1.7	1.2	0.6	0.4	0.4	0.3
Other sectors*	1.9	1.4	0.9	0.7	1.0	0.8	1.2	0.9

Resource: Economic development of Latvia. Report, 2001

*Investment projects of the Ministry of Economy, Ministry of Foreign Affairs, Secretariat of the Special Tasks Minister for Public Reform, State Land Service, National Radio and TV Council.

Investments from the central government basic budget in 2001 compared to 2000 have gone up by 33.5 percent. This is partly due to the fact that foreign financial aid to the basic budget is transferred to the central government basic budget, the same as revenues of institutions from market services and other "private" revenues. The planned amount of state loans and state guarantees compared to actual credit utilization in 2000 has gone up by 21 percent and equals LVL 52.1 million.

PIP financing starting with 2001 is extended to the ISPA transport project "Improvements to VIA Baltica Route and West – East Corridor", two regional waste management projects (Liepaja, Ventspils) and three water supply and sewage service development projects (Riga, Jelgava, Ventspils).

4.1.5 Public Investment Program for 2002.

Total funds of PIP for 2002 consist of: LVL 66.9 million from the central government basic budget, LVL 6.3 million from the special budget, LVL 31.3 million from loans, including the newly issued state guarantees for LVL 6.4 million. There are also plans to attract private resources of program executors and donations in the amount of LVL 24.5 million.

4.2 MAJOR REGIONAL DEVELOPMENT INSTRUMENTS AND ACTIVITIES IN LATVIA (1996 – 2002)

4.2.1 Addressing Regional Development Issues

In section 5.3 of the Concept of Regional Development Policy of Latvia, it is stated that:

"the state implements the regional development policy directly by state investment programs, branch development programs, grants and subsidies, tax reduction and the financial resources of the Regional Development Fund. To foster the regional development processes, public financial resources must be allocated for drafting development plans, programs and territorial planning in all local authorities and regions. Local authorities of regions, rural districts and towns should provide in their budget money for development measures. The state budget should allocate additional means for the Latvian Development Agency, Support Centers for Entrepreneurial Activity, Agricultural Consultative Centers and Adult Education Centers for implementation of regional development policy."

Policies and instruments in virtually every sector of activity may have an indirect impact on regional development, even the programs, which are pure sectorial ones. During the time from 1996 to 2002 several ministries implemented a variety of programs and managed funds, which more or less directly were targeted at specific regions and/or regional development problems. Within this period, several ministries shared the tasks of regional development policy and the activities listed below were part of their sector programs. This resulted in an incoherent approach to these programs and difficulty evaluating the impact. But even lacking targeted regional policy, these activities still contributed in improvement of infrastructure in the regions and the capacity building of local and regional levels in programming and project management.

4.2.2 The Regional Development Fund – (Ministry of Economy)

The Regional Development Fund had been established to ensure the implementation of regional development policy and to finance regional development activities with priority to be given to special support regions. Each project is required to have a business plan, which meets the regional development requirements. The Regional Development Board in co-operation with local authority concerned assesses the project. The following criteria are to be observed in the assessment of submitted projects:

- the number of newly created working places and their quality;
- the competitiveness of production;
- the possibility to replace imported production by local production;
- use of local resources;
- restructuring and use of former production units;
- investment in listed natural areas, cultural and historical monuments.

Start of Activities: 1997 (the fund is still operating, but now under the Ministry of Finance, see section 3.6, the operation of the fund most likely will change in accordance with the new system for management of PHARE Economic and Social Cohesion in Latvia)
Aims: To create opportunities for accelerated economic development of the assisted regions in order to promote the formation of equal socio-economic conditions in the whole territory of Latvia. To promote entrepreneurship in assisted regions by supporting projects, which have a justified business plan and a program of activities, the implementation of which are in the interests of corresponding local authority.
Organization: The Regional Development Council is the supervisory authority. The Fund also has a "Consultative Commission" consisting of experts from the Ministry of Economy, Finance, Welfare, Transportation, Environmental Protection and Regional Development, Agriculture and Union of Local and Regional Authorities. The executive institution is a state non-profit enterprise in the form of the state limited liability Company "Development of regions".
Applicants: Municipalities, enterprises
Type of Financing: Interest subsidies, extraordinary payments, and subsidies in fixed assets.

Measures To Be Supported:

- Investments in statutory capital related to research activities and the purchase of patents - in this case the support from the Fund should not exceed 35 percent of the total costs of activity;
- Partial or full interest rate subsidies;
- One-off activities, such as training and support to enterprises for creation of additional work places;
- Venture capital holding - in this case the support from the Fund should not exceed 20 percent of the total costs of activity;
- Support for local development funds and for the development of regional development programs;
- Co-financing of infrastructure development in the regions;
- Activities initiated by local / regional governments aimed at promotion of business activity (including payments for specialist assistance).

Evaluation Criteria: Compatibility with the relevant regional development program, quality of business plan.

The Consultative Commission of the Regional Fund comprised of delegated experts from the Ministry of Economy, Ministry of Finance, Ministry of Welfare, Ministry of Transport, Ministry of Environment Protection and Regional Development and Ministry of Agriculture and from the Union of Regional and Local Governments reviews and passes decisions in regard to every application/project submitted by potential beneficiaries.

Total Budget by Year:

1997 – LVL 1.0 million
1998 – LVL 1.0 million
1999 – LVL 1.2 million

Projects Approved: Total revenues of the Regional Fund during the first three years;
(1998-2000) equaled LVL 2.75 million;
(1998 – LVL 1.403 million; 1999 – LVL 350 thousand; 2000 – LVL 1 million.)
The projected revenues for 2001 are LVL 0.8 million, in 2002 – LVL 0.992 million.

From the beginning of the work of the Regional Council to November 2001, the Consultative Commission of the Regional Fund has approved co-financing grants from the Regional Fund to 659 business development projects and has entered into 599 agreements on co-financing from the Regional Fund. Of all the concluded agreements, 539 agreements were made with businesses and 60 – with local governments (see Box 1). Of which, 89 were concluded in 2001. The comparatively small number of concluded agreements is attributed to the fact that allocation for the Assisted Areas Program (Regional Fund) from the state budget in 2001 was only LVL 0.8 million, which is the amount necessary to pay for costs to continue co-funding of the already approved projects.

4.2.3 Projects of Local Governments

From the initiation of the work of the Regional Fund to July 1, 2001, local governments have implemented 24 infrastructure development and business support projects, of which 15 projects were related to the establishment business support and information centers and establishment of tourist information centers (TIC) and 9 projects were focused on the creation of business and tourism development supporting infrastructure.
LVL 207 thousand were used to set up the above-mentioned centers, including:
LVL 97 thousand or 47 percent of total project costs disbursed by the Regional Fund;
LVL 83 thousand or 40 percent from total project costs contributed by local governments;
LVL 28 thousand or 14 percent of total project costs drawn from other sources of funding.

The fifteen newly created business support and tourist information centers created 30.5 new jobs and 4 jobs during the tourist season. More than 44 new enterprises were created in the result of work of the centers providing more than 90 jobs. Twenty unemployed persons found jobs as a result of training and consultation organized by the centers.
From all the established centers:

- 2 centers operate as tourist information centers (Kraslava region TIC, Ozolmuiža TIC),
- 8 centers operate as business information and support centers (Business information center in Livani, Small Business School in Valgunde municipality Kalnciems secondary school, Vārkava region Business Support Center (BSC), Rušona municipality BSC, Kaive municipality BSC, Līvbērze municipality BIC, Dignāja municipality information office, Naujene municipality information center),
- 5 centers operate in both the areas (the biggest being – Not for Profit Development Center “Dagdas Fenikss”, Augšzeme tourist center in Svente, training and recreation center “Vestiena”, information – consultation center in Jūrkalne, business information support center in Sabile).

The key activities of business information and support centers are:

- Collection and aggregation of information relevant for business development;
- Providing information and consulting to businesses and local governments;
- To organize training courses and seminars;
- Project development;
- To organize events aimed at promotion of business activity;
- To provide technical office services.

The key areas of work of tourist information centers are:

- to collect, aggregate and disseminate tourist-related information,

- to consult starting companies in the area of tourism,
- travel services (project development, tour guiding, organizing all types of travel, etc.),
- participation in travel fairs.

By September 1, 2001, the Fund had made 39 agreements with local governments on implementation of infrastructure and business promotion related activities, which, according to projections, will receive LVL 186 thousand from the Regional Fund. Of the mentioned agreements, twenty-two are targeted at establishment of business information and support centers, six at establishment of tourist information centers and the other eleven at co-financing of business and tourism support infrastructure.

One of the key goals of the Assisted Areas Program is to encourage business activity and to create new jobs. The results of work of the Regional Fund in the first half of 2001 show that the projects supported by the Regional Fund have created 326 new permanent jobs and 568 seasonal jobs and have helped to retain 238 jobs in the assisted areas. Approximately LVL 1080 of Regional Fund's resources were used to create each new job.

Since the very outset of the operations of the Regional Fund, each LVL used from Fund resources attracted slightly more than LVL 24 of total investment in business development projects, of which LVL 22.6 were contributed by businesses.

In 2001, the Regional Fund, in co-operation with the Ministry of Environment Protection and Regional Development, Latgale Development Agency and Latgale local governments, started a joint project – "Pilot Project of Urban Development". This was aimed at perfection of the business environment and will benefit from resources of local governments, the Regional Fund and PHARE program. The Regional Fund will contribute co-funding in the amount of LVL 24 thousand. This is the first project of this type, where the Regional Fund directly contributes financing.

4.2.4 Subsidies for Territorial Planning and Drafting Development Projects – (Ministry of Environment Protection and Regional Development (MEPRD)).

Start of Activities: 1996
Aims: To support and promote territorial planning and elaborate development projects.
Organization: Commission for allocating earmarked subsidies, territorial planning and working out development projects.
Applicants: Municipalities.
Maximum Amount: LVL 7000 for one rural municipality or town.
Assistance: LVL 15 000 for one region or city of Republic. Co-funding of about 25 percent of total requested amount is required from local/district authority
Type of financing: Grants
Priorities for grant distribution (1998):

- Development of administrative-territorial reform proposals and implementation of administrative-territorial reform;
- Development of common development and spatial plans based on agreements concluded between various authorities;
- Elaboration of plans in border areas;
- Development of plans in assisted areas;
- Demonstration projects and methodology development;
- Participation in inter-state spatial and development planning projects.

The Regulations also state that grants can be assigned for implementation of projects promoting the development of the municipality or region, create new jobs and use local resources, if such projects are included in the previously elaborated development plan. In this case co-funding of 60 percent is expected from the local or district authority.
Measures to be funded:

- Administrative costs — management and coordination of planning process;
- Hiring of experts and consultants;
- Research and development of projects;
- Purchase of cartographic materials and statistics data;
- Purchase of computer equipment and software, including digital maps;
- Ensuring public participation;
- Training of planning specialists;
- Copying or printing of final materials.

Evaluation criteria: Compliance to priorities, quality of submission.
Total budget by year:

1996	LVL 570.991	1997	LVL 1.0 million
1998	LVL 1.0 million	1999	LVL 350,000
2000	LVL 431,661	2001	LVL 440,000
2002	LVL 440,000		

Output: Altogether more than 300 municipalities have received grants.

4.2.5 The Municipal Development Fund (Ministry of Economy)

Start of Activities: 1996 – 2002 (commitments taken over by the State Treasury)
Aims:

- to mobilize financial resources and make them available for municipalities for investments projects in infrastructure;
- to strengthen the operational capacity and efficiency of municipalities;
- to give assistance in the preparation and evaluation of project schemes;
- to give assistance in organizing public procurement for the projects.

Organization: The Fund was governed by the MDF Board, which comprises representatives from the Ministries of Economy (PIP), Ministry of Finance (advisor to the State Secretary on Local Government Issues), MEPRD (Director of the Investments Department and Director of the Administration of Municipal Affairs) and the Union of the Local Self-Governments.

The Board has established a Working Group (based in the Ministry of Economy) consisting of a specialist project coordinator, economist, engineer and financier. After economic analysis, the Board examines municipal long-term investment projects within the Work Group and takes decisions about the accordance of the projects with MDF rules before submitting them to the Ministry of Finance.
Applicants: Municipalities and municipal enterprises.
Type of Financing: Credits
Conditions of Financing:

- Maximum credit is $1 million.
- The maximum MDF contribution is 80 percent
- The interest rate is 8.2 percent
- The period of repayment is 10 years (17 years for environmental projects)

- Public procurement is carried out according to the World Bank procedures

Target Sectors:

- Energy and municipal economy
- Transport and communication
- Environmental protection
- Education and health
- Social care

Output: Twenty-eight projects have been accepted for funding from the Municipal Development Fund. Nineteen of these projects have been implemented or are at the implementation stage. The total value of these projects is USD 2.869 million.

4.2.6 The Rural Development Program (MEPRD).

Aim: To facilitate structural change in rural areas.
Organization: The Regional Development Council was responsible for the coordination of the Program through an Inter-Ministerial Working Group. The group included representatives of the following ministries and institutions: VARAM, Economics, Agriculture, Justice, Finance, State Land Service, Latvian Mortgage and Land Bank, State Employment Office and World Bank. Within MEPRD, the program is implemented through the Division of Sustainable Development within the Regional Development Department and there is a World Bank Technical Assistance Unit with two local experts dealing with preparation and supervision of the program from the World Bank side.
Detailed Objectives:

- To facilitate the environmentally friendly development of agricultural and forestry production and processing and enhance the competitiveness and export potential of Latvian agriculture,
- To support non-agricultural businesses and service sector as an important consistent part of rural economy which creates new (alternative) jobs;
- To direct capital investments to the countryside;
- To facilitate the development of districts and regions facing difficulties;
- To preserve the rural population, environment and landscape for recreation and tourism purposes for the next generations;
- To publicize and promote the Latvian rural development policy domestically and internationally;
- To prepare Latvia for utilization of resources from the EU Structural and Cohesion Funds, to implement the rural development program and projects which would testify to the readiness of Latvia to use these resources efficiently.

The program was targeted at rural areas, which for the purpose of this program have been defined as all of Latvia excluding seven urban clusters. For the Special Rural Finance Credit line to support small-scale borrowers, the "Assisted areas" as defined by the Ministry of Economy in the eastern and northern part of Latvia will be considered "priority" areas, although other areas will not be excluded.
Time-Scale and Budget: The Rural Development Program has been elaborated as a long-term strategy for structural change of rural areas (ten or more years). Operational programs will concentrate on medium and short-term activities. Several million Lats were assigned in the national budget for the program. This amount is comprised of the national budget sums allocated for sector activities, which ministries see as directly or indirectly affecting rural

development. Additional co-funding will be provided by Latvian credit institutions (USD 3.8 million), other donors, recipients and beneficiaries.

A World Bank loan of USD 25 million has been provided for a period of five years. On July 31, 1998, it was decided to allocate USD 10.5 million for a first phase of expenditure. Of this money, USD 0.5 million will be used for policy formulation, USD 8 million for credit line to farmers and rural entrepreneurs, and USD 2 million for institutional development, completion of land reform and development of the mortgage system.

The state share company Rural Development Fund, has been established and with its LVL 4 million in capital, it provides guarantees to entrepreneurs from rural areas who lack a credit guarantee if they want to take credits in Latvian banks in the scope of the SAPARD program or the Agricultural long term investment crediting program. Up to now, the fund has guaranteed more than 550 credits of rural entrepreneurs and the total sum of credits received with the guarantees of the fund has exceeded LVL 19 million.

4.2.7 European Union Cross-Border Co-operation Programs (CBC, Baltic Project Facility, and CREDO)

Time of Activities: 1994 – 2000
During the period from 1994 – 1999, the objectives of the Baltic Sea region Cross Border Co-operation Program stated in the Multi-annual Indicative program were as follows:

- To improve communication, infrastructure and transportation links within the Baltic sea region, in particular to complement the development of a East-West European Transport Network of the "Via Baltica";
- To protect the environment and reduce pollution levels, particularly regarding the Baltic Sea;
- To encourage cross-border co-operation as a mechanism to maximize the growth potential of the Baltic Sea Region as a whole and to complete the transition to a full fledged market economy;
- To stimulate new and support existing co-operation between local and regional authorities in the countries of the Baltic Sea Region;
- To support activities which facilitate the preparation of the Baltic States and Poland for accession to the European Union.

The following priorities were defined:

- Transportation, including border crossing improvements;
- Environment;
- Utilities and Municipal Infrastructure Provision;
- Economic Development;
- Human Resources;
- Technical Assistance and Program Management.

In Latvia main focus was targeted at the development priorities of transportation, environmental and human resources.

Transportation: The total allocation under the Cross-Border Co-operation Program allocated for the transportation sector was 36 percent. Twelve percent of the total went for road improvements and 24 percent went for maritime issues.

In the road sector all projects were targeted to the road improvement on the "Via Baltica" road span between border with Lithuania and Riga city.

In the maritime sector main activities were targeted to the improvement of the ports facilities (like: Vessel Traffic Control Tower in Riga port and Sheet pile wall in Liepāja port) and to the raising of the safety level on the sea (like: renovation of lighthouses and harbor lights at small ports of Latvia).

Environment: The total allocation under the Cross-border co-operation program allocated for the Environment sector was 60 percent. Forty percent of the total went for waste-water treatment, ten percent went for waste management and 10 percent went for other different environmental projects.

Financing was provided for improvement of the wastewater treatment facilities in seven towns of Latvia, which led to the considerable reduction of the pollution level in wastewater discharged into the Baltic Sea.

Under waste management, the review of the National Hazardous Waste Management Strategy was completed, the Gardene hazardous waste storage facility was established and equipped, more than 800 tons of historically un-owned hazardous waste was collected, sorted and disposed in the Gardene facility.

In the environment sector, there were a number of projects concerning raising of public awareness about environmental issues (establishment of the Environmental Media Center, Environmental Education Projects Competition), upgrading of environmental laboratories for environmental monitoring and pollution control issues, increasing of the technical capacity for handling of oil pollution in the Baltic Sea.

Human Resources: Around four percent of total financing was allocated to this priority. Some projects were clearly educational (Education of Local Governments, Reinforcement of Institutional and Administrative Capacity) while some others had economic development features (Regional Development, Spatial Development along the Tampere-Helsinki-Tallinn-Riga development zone). In frame of the project Co-operation Council of Border Regions, assistance was provided to the Co-operation Council on Latvian-Estonian-Russian border.

Within the frame of the PHARE CBC program the investments have been as follows:

- For environmental projects implemented by the Ministry of Environmental Protection and Regional Development and the project-initiators, the total sum of PHARE funding is EUR 10,893,714. Thirteen projects were implemented with average funding of EUR 837,978.
- For transportation projects implemented by the Ministry of Communications and the contractors, ten projects were completed with total EU funding of EUR 7,109,024 or and average of EUR 710,902 per project.
- For projects implemented by the Latvian – Estonian- Russian Council for co-operation of border regions, the total amount of funding is EUR 185,000, which partly covers LV-EE and LV-RU border regions of the partners of co-operation.

Within the frame of the PHARE CREDO program during the time period of 1997 to 2000, twelve projects with a total budget of EUR 511,000 were partly financed by the PHARE CREDO program in Latvia. CREDO finances were EUR 402,000; the average co-financing rate is 79 percent. Total area and population covered by these projects is approximately 12,000 km^2 (18 percent of Latvia) and 300,000 inhabitants (12 percent).

All projects implemented under PHARE/TACIS Baltic Project Facility during the first two years of the program amounted two twenty-one projects. The total amount of European funding is EUR 1,897,021, of which PHARE finances are EUR 1,821,951 and TACIS finances are EURO 75,070. The average financing per project is EUR 90,334.

In the framework of the PHARE/INTERREG Facility, three projects were implemented with total European funds of EUR 1,152,400. The average funding per project is EUR 384,133.

While acknowledging the positive outcome of the PHARE CBC program, the deficiencies of the program should be looked at for the purpose of a more comprehensive new CBC program in future[3]:

- A comparatively small number of projects within the CBC program were genuinely of cross border nature;
- Insufficient priority was given to projects which are primarily for the benefit of the population of the border regions (Court of Auditors report);
- The level of involvement of the local/regional authorities in the CBC programming was unsatisfactory;
- Some of the projects focused on national priorities rather than being specifically in the interest of the local population in the border regions (Court of Auditors report);
- The program suffered from a number of programming and design weaknesses, which had a serious impact upon the achievement of program objectives, e.g. Lack of a measurable cross-border element, several wider and immediate objectives were not accomplished by the activities (OMAS assessment report);
- Program management procedures of both the beneficiary countries and the Commission were too centralized (Court of Auditors report);
- No formal structures were established to coordinate the implementation of the CBC program after it has been approved in the BCC (OMAS assessment report).

4.2.8 The SPP Urban Pilot Project (MEPRD)

Time of activities: February 1999 to November 2000.
General objective: To integrate assisted activity in all sectors into a coherent strategy for sustainable urban development/re-conversion and to test and refine this strategy in practice

This experience should confirm and develop the capacity of those involved to design and implement regional development projects which conform with the principles and procedures of the Structural Policies of the European Union.
Specific Objectives:

- To elaborate an Integrated Sustainable Development Strategy for urban areas of Latgale;
- To design a training package to raise the regional capacity by establishing appropriate structures in the region;
- To involve local actors in the implementation of the strategy through local development plans (including establishment of local community partnership structures, and planning and delivery of both soft investment assistance - focused training and exchange of experience - and hard investment assistance - both on-site and complementary small-scale infrastructure development) and so both create employment and refine the overall strategy;
- To provide a more thorough experience of one aspect of integrated programming by co-financing the Latvian Regional Fund to provide small-scale infrastructure associated with development activities.

Target groups:

[3] Joint Programming Document for Phare Cross Border Co-operation program 2001 –2006

- The Latgale region: Districts of Kraslava, Daugavpils, Rezekne, Preili, Ludza, Balvi as well as Rezekne and Daugavpils City;
- The Latgale Development Council which include the following local authorities: representatives of six district councils, two city councils and Association of Latgale towns;
- The Towns Council of Latgale, which includes representatives of the following nine towns: Dagda, Zilupe, Kraslava, Preili, Balvi, Ludza, Vilani, Varaklani and Livani;
- The relevant department of the MEPRD.

Cost breakdown: The total cost for the implementation of the project is ECU 760,000. EU assistance will cover 72 percent (ECU 550,000) of the total cost of the project, the remaining 28 percent will come from Latvian Municipal budgets (ECU 50,000) and the State budget (ECU 80,000 as a subsidy for physical and development planning)
Actions:

- Formulation of an Integrated Sustainable Development Strategy for Urban areas of Latgale;
- Preparation and implementation of local development plan(s);
- Co-financing the Latvian Regional Fund for investment in small-scale infrastructure across the Latgale region.

4.2.9 The SPP Rural Pilot Project (Ministry of Agriculture)

Time of Activities: March 1999 — 2000
General Aim: The pilot project is designed as a learning–by-doing exercise to develop the Government's administrative capacity to administer and account for pre-accession structural assistance, through implementation the selected small-scale, short duration, well-focused measures which address structural adjustments in agricultural sector and specific aspects of rural development.
Specific Aims: The specific aims of this project relate both to the installation of administrative capacity for the national/regional management structures in restructuring the agricultural/rural sector and the introduction of genuine EU structural aid-schemes for the rural population. Smooth administrative and co-operation mechanisms between the different authorities involved, as well as appropriate performance of beneficiaries should be attained during the life span of the project.
Target Groups:

- Ministry of Agriculture;
- Ministry of Education/Center of Professional Education;
- Ministry of Economy/Regional Fund;
- Ministry of Welfare/Employment Service;
- Local Agricultural Advisory Service.
- Local governments and social and economic partners, whose involvement is anticipated in the rural assistance scheme

Specific Actions:

- Technical assistance
- Investments (5a type)
- Training of beneficiaries
- Investments/Development projects (5b —type)
- Training of rural households

Total Budget:

PHARE contribution: ECU 538.080
National Contribution: ECU 483.080

4.2.10 The Integrated Development Program for Latgale (MEPRD)

General Objectives of Activities:

- To develop the capacity of the Latgale region in relation to regional development activities and to create an ability to effectively access national and international assistance programs, especially in the context of EU integration as well as self sustaining development of the region.
- To prepare an Integrated Regional Development Plan, which covers the Latgale Region which meets the detailed objectives set out below

Specific Objectives:

- To provide a comprehensive framework for the short, medium and long-term development of the Latgale Region, including the setting up of a regional development agency;
- To demonstrate the use of regional planning data and planning techniques;
- To provide guidelines for planning and economic development within each district, Republic City and as appropriate at a strategic level within each *Pagast*;
- To provide practical experience and training in regional development and planning, program development and other related issues for district staff in *Rajons* and Republic cities within Latgale as well as relevant staff from MEPRD;
- To recommend specific actions concerning management and investment which should be considered for implementation in a phased manner;
- To support other activities important to reinforce the capacity of local authorities to undertake development initiatives, especially where these serve as pilot actions;
- To ensure that such actions are within an overall context of sustainability.

Total Budget: ECU 500 000.

4.2.11 The Integrated Coastal Zone Management Plan (ICZM), (MEPRD)

General Objective: To support the implementation of the Baltic Sea Environmental Program and its long-term objective of ensuring the ecological restoration of the Baltic Sea and the preservation of its ecological balance.
Specific Objectives:

- To provide a policy, regulatory, institutional and management framework for short, medium and long term planning and management of the coastal zone;
- To provide guidelines for planning and development in the study area;
- To recommend actions concerning management and investment programs;
- To identify action to reduce the pollution load reaching the Baltic sea;
- To produce ICZM plans that are a form of consensus as to what is important in the coastal zone.

There are five local planning units established within the frame of the project, which cross rural municipality and regional boundaries as well as five working groups. The task of these local working groups is to cooperate with each local government to prepare local development plans for each planning unit. The task of the National working group within the Ministry of

Environmental and Regional Development is to prepare the National ICZM plan for all project areas.

4.2.12 The Coastal Investment Strategy (MEPRD)

General Objectives:

- To provide a framework for the short, medium and long term investment in the coastal zone;
- To identify actions concerning investments which should be considered for implementation in a phased manner.

The Coastal Investment Strategy will include:

- Development of a scheme for prioritization of investment on an area basis;
- A clear strategy for sourcing, receiving, allocation, coordination and managing investments which will have an impact on the coastal regions of Latvia.

Policies and instruments in virtually every sector of activity may have an indirect impact on regional development. Fishing and forestry schemes are obviously most relevant to particular regions of Latvia and such programs as "800+" (which deals with water supply and waste water treatment in small towns) may have a particular geographic target. However, these remain essentially sectorial instruments.

The sectors, which are of particular relevance to regional development are the transportation and environment sectors, we therefore provide some details on the main activities in these sectors below.

4.2.13 The 800+ Program

In order to solve water supply and waste water treatment problems in small and medium size towns of Latvia, the National Program 800+ "Water Supply and Waste Water Treatment in Small and Medium Sized Towns of Latvia" was established. The 800+ Program in practice covers all urban areas. In Latvia approximately a hundred towns are included accounting for approximately 35 percent of the total population of Latvia. Riga is not included in the 800+ Program. Only 23 towns (Table 7.1) in Latvia exceed 10,000 persons, with a total population of approximately 1.5 million. Of these, approximately 800,000 people reside in Riga and 792,000 elsewhere.

The Program 800+ consists of 4 phases:

- Inventory of the existing situation and development of a data base;
- Development of strategy for renovation and further development of water services management in small and medium sized towns;
- Prioritization of investments and pilot projects, development of a financing pattern and the necessary investment program;
- Implementation of program.

The first step to implement the program was the inventory of all wastewater treatment plants and water supply systems in the largest towns (above 2000 inhabitants). This inventory and additional studies showed the baseline situation in the water sector from which an investment strategy was formulated. The investment strategy indicates the main activities for improvements in water service sector up to year 2010. The identified key activities are:

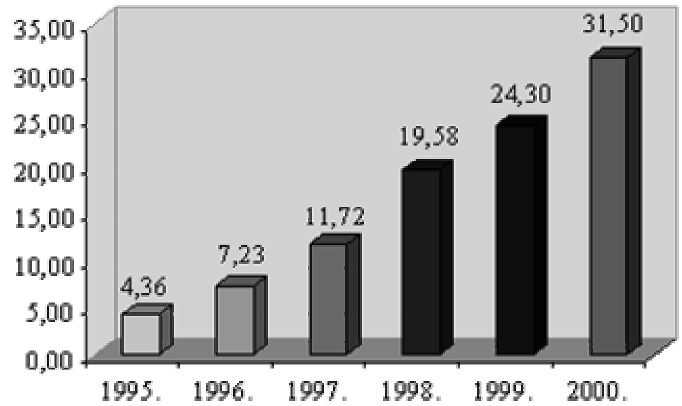
- Technical projects aimed at improvement of potable water quality, waste water collection and treatment;
- Institutional strengthening projects;
- Regional water management including integrated river basin watershed management plans;

- Pilot or demonstration projects for smaller communities that can not afford a full scale project.

With assistance from EU PHARE, the first 3 phases of the 800+ Program were completed by 1996. The Cabinet of Ministers adopted the 800+ Program in January 1997. In order to implement this strategy, the 800+ Project Support Unit was set up.

The 800+ Program addresses all small towns in Latvia including those with a population of less than 2000. The 800+ Program will be fully implemented by 2020. EU compliance is required for towns with a population above 2000. Full EU compliance will be achieved by 2015.

Picture 4.1. Investments in Water Sector Infrastructure (1995-2000), Million LVL



4.2.14 Program 500-

Latvia developed a Municipal Solid Waste Management (MSWM) strategy and subsequently established the Municipal Waste Management Program 500-. The Program 500- is an action plan for implementing improvements in the field of solid waste management and for reducing the waste load to the environment. The 500- Program has the following priority objectives:

- To establish common waste registration system;
- To elaborate fee system for waste management services;
- To develop regional waste management strategies;
- To create 10-12 municipal sanitary waste disposal sites for municipal waste;
- To ensure profitable circumstances for recovery and recycling of municipal waste;
- To separate dangerous municipal and clinical waste from the total municipal waste flow;
- To assess the influence of existing waste disposal sites and closed sites to public health, watercourses, protected areas, etc.

Development of the regional waste management strategies will provide the planning context as required by waste framework directive.

The following summarizes the status of solid waste management projects in the framework of the Program 500-:

- Implementation stage - Liepaja, Ventspils, Talsi, Riga and North-Vidzeme projects;
- Preparation stage - Maliena, East-Latgale and South-Latgale;

- Possible future projects - Jekabpils, Madona, Aizkraukle, Jelgava, Bauska, Tukums, Jurmala, Saldus, Dobele and Kuldiga.

Within the frame of Public Investment Program, LVL 4.4 million have been invested in the waste management sector in the period 1995 to 2000. In 2000, the state has invested LVL 1.1 million in waste management sector.

4.2.15 State Road Fund (Ministry of Transport)

Start of Activities: 1994
Aims: To ensure sufficient and stable financial resources for maintenance of state roads. Form financing for improvement and development of the state road network and to subsidize city municipalities to enable them to maintain, to repair and to develop transit roads (streets) in conformity with the volume of transit traffic
Organization: The Ministry of Transport is the holder and manager of State Road Fund. A State Road Fund Advisory Board has been established for reviewing the general strategy on revenues and expenditures of the State Road Fund, as well as state road expenditure program, for reviewing the use of funds at local level.
Target Sectors:

- State road maintenance;
- State road repairs and rehabilitation;
- State road reconstruction and building;
- Forecast of state road network development, program and project preparation;
- Road industry technical development;
- Consultancy service for the municipalities within the field of road (street) maintenance and supervision;
- Organizing, planning and technical management and control of the works of state road maintenance, repairs and construction;
- Development of access road service and infrastructure;
- Subsidy of city municipalities to maintain, repair and develop transit roads (streets);
- Activities relating to environmental protection and re-cultivation of lands lying along state roads.

Type of Financing: Subsidies.

Table 4.5. State Road Fund Expenditures (million LVL)

Type of expenditure	1996	1997	1998 (planned)	1999 (planned)
Financing of state roads	17.97	22.30	30.31	47.76
Financing of development of rural roads	-	-	-	11.34
Earmarked subsidies for financing municipal roads (streets)	7.4	11.46	13.59	15.67
Earmarked subsidies for passenger transportation with busses in rural areas	1.1	4.5	5.6	7.4

Table 4.6. State Road Fund Expenditures (thousand LVL)

Type of expenditure	2000	2001	2002
1. Compensation to JSC "Latvian Railway" from excise duty	4,650.37	3,763.33	4,000.00
2. Donation from excise duty to regular passenger bus transport in rural areas	6,520.27	5,157.20	7,233.00
3. Donation for municipal roads (streets)	11,524.10	11,132.73	15,844.00
3.1. from annual vehicle tax	2,348.09	2,490.00	3,274.00
3.2. from excise duty	9,176.01	8,642.73	12,570.00
4. Rural road financing	5,819.67	3,201.84	10,000.00
5. State road financing	34,664.90	41,059.61	34,575.00
Total	63,179.31	64,314.70	71,652.00

*Resource: date of the Latvian Road Administration

After the amendments to the Law on Excise Duty on oil products, which provides more than ten percent of the State Road Fund, it is foreseen that the development of rural roads will be financed on the base of projects starting from the year 1999. Priority will be given to the roads, the construction of which are in the interests of at least two regional authorities.

4.2.16 The Port Development Fund

Start of activities: 1992

Aims:

- To accumulate additional resources for development and reconstruction of ports of Latvia, especially small ports;
- To provide the participation of the Republic of Latvia in international maritime and fishery organizations;
- To generally assist in the solution of those state port development problems, which are in the competence of the Fund.

Applicants Appropriate: port administration

Type of Financing: Subsidies

Organization: The Latvian Port Council supervises the Port Development Fund and the Latvian Maritime administration manages the Fund.

Target Sectors:

- Development and reconstruction of ports of Latvia, especially small ports;
- Sandbank dredging for maritime and fishery needs;
- Payments to international maritime and fishery organizations;
- Stipends for preparation of Latvian maritime specialists.

Evaluation Criteria: To receive the financing from the Fund, the application and business plan have to be submitted by port board to the Latvian Maritime Administration five months before fiscal year.
Output: Up to now, the investments from the Fund for small ports have been targeted only for repair of hydro-technical facilities, harbors and deepening of ship canals.

4.3 BORROWING

The Bank of Latvia (the central bank) implements the monetary policy of Latvia. The law, On the Bank of Latvia, stipulates that the main goal of the monetary policy is to maintain price stability. The central bank is independent in its decision-making and is not subordinated to decisions or orders of the government or government institutions. The Bank of Latvia is supervised by the *Saeima*.

Since the middle of February 1994, the Bank of Latvia has unofficially pegged the exchange rate of the LVL (lats) to the SDR[4] currency basket (1 SDR = 0.7997 LVL), thus implementing *de facto* the fixed national currency exchange rate policy (see details on the exchange rate policy in 3.5.4). The Central bank plans to preserve the current pegging of the LVL to the SDR till the time when Latvia accedes to the EU. The Bank of Latvia has managed to gain confidence without establishment of a formal currency board system and has also accumulated experience, at the same time using a wide range of market-oriented monetary tools fully compatible with the monetary policy instruments at the disposal of the European Central Bank (ECB).

Assets of the five largest banks amount to three-quarters of total bank assets. Almost all banks are private. The share of the state in fixed assets of the banking sector is 3.7 percent. A more substantial share of state capital is found only in two banks, the Mortgage and Land Bank of Latvia at 100 percent and Latvijas Krājbanka (Savings Bank of Latvia) at 32 percent (privatization of this bank continues). Two-thirds of paid fixed capital is non-resident investments. Main shareholders of Latvian banks are German, Swedish, Finnish, Estonian and Russian banks and several important international financial institutions (EBRD, Swedfund, etc.).

The banking sector of Latvia is stable. Bank assets, deposits and extended loans are gradually going up. Commercial banks are profitable. Further increase of the efficiency of the banking system is closely linked with the development of the national economy, structural reforms, development of capital and real estate market. The strengthening of the banking sector is encouraged by the appearance of respectable foreign banks (Skandinavske Enskilda Banken, MeritaNordBanken, Norddeutsche Landesbank, etc.) in the financial sector of Latvia.

Bank supervision implemented in Latvia, according to the opinion of many foreign experts, is one of the strictest among the countries of Central and Eastern Europe. Many regulatory requirements for lending institutions in Latvia are even stricter than in the countries of the European Union, especially concerning classification of loans and rules of saving.

On July 1, 2001 a new independent financial supervision institution, the Financial and Capital Market Commission (FCMC), started its work uniting former functions of the Credit Institution Supervision Board of the Bank of Latvia, Stock Market Commission and State Insurance Supervision Inspection. The FCMC was set up to protect interests of depositors, bank customers and the insured persons, as well as guarantee stability and development of financial and capital markets.

[4] Special Drawing Rights – SDR; currency code according to the classificator of international currencies is ISO 4217 – XDR.

In accordance with the law On Natural Person Deposit Guarantees, the maximum guaranteed amount of compensation to one depositor for a deposit in a bank is gradually increased (at the moment it equals LVL 1000). It is planned to raise this amount to LVL 13,000 by January 1, 2008. Matching the requirements of EU directives, *Saeima* adopted amendments to the law (gaining effect on January 1, 2003) to enable applying the guarantee system also to legal persons. The planned maximum amount of the guarantee will be identical both for natural and legal persons. In accordance with the above changes, the name of the law was changed and is now called the Law on Deposit Guarantees.

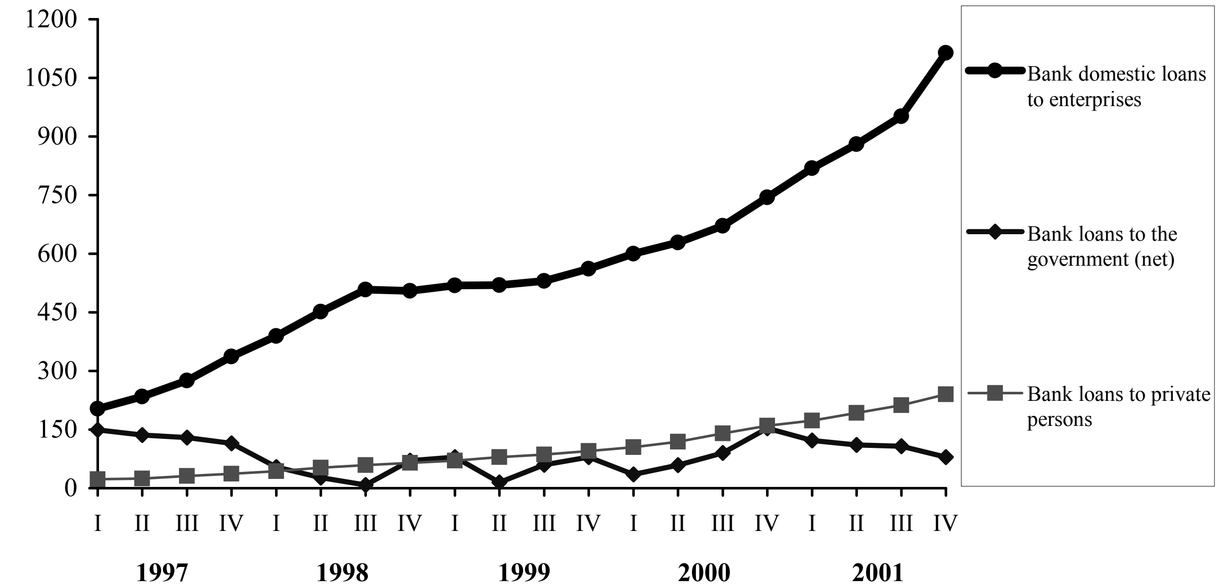
The Stock market plays an important role in the attraction of investments. At present, the necessary legal base for the development of stock market in Latvia is in place corresponding to the requirements of the EU directives. Yet, the stock market in Latvia is in a very early stage of development, therefore it has a rather small impact on the economic development.

Deposits of enterprises and private persons steadily went up before the Russian crisis (end of July 1998) and in 1997 increased by 50 percent. A relatively more stable political and economic environment in Latvia encouraged inflow of short-term capital from Russia and other CIS countries. At the outset of the crisis, non-residents from the CIS withdrew their money to use it to solve their more urgent problems. Therefore, in the second half of 1998 both time deposits and demand deposits essentially went down. At the end of 1998, compared to the pre-crisis period, deposits had gone down by almost 10 percent. Starting with the second quarter of 1999, deposits in banks started to go up again. There is a tendency of growth in the share of time deposits in the total structure of deposits. At the end of 1999, this equaled 35 percent while at the end of 2000 it was 40 percent, and at the end of November 2001 it was still 40 percent. At the moment, approximately half of total deposits are deposits of non-residents. In the first nine months of 2001, the resident deposits went up faster (by 20.8 percent) than non-resident deposits (by 5.6 percent).

A relatively high share of short-term deposits and non-resident deposits contains a certain risk factor. Economic shocks may result in a dramatic decrease in deposits, which could significantly influence the total banking system of Latvia. However, due to strict measures of bank supervision and control, such a situation is hardly possible. The Law on Deposit Guarantees also promoted trust in banks.

The amount of loans granted to domestic enterprises and private persons went up substantially in 1997 (by 77 percent) and in 1998 (by 52 percent). In 1999, this slowed down under the impact of the Russian crisis and growth equaled 15 percent. In 2000, total borrowing went up to 38 percent and in the first 11 months of 2001 it was 35 percent. During recent years, the share of loans against the GDP are going up. In 2000, they totaled 21 percent, yet substantially lagged behind in similar indicators in the developed countries. In the first nine months of 2001, 86 percent of all loans were disbursed to resident beneficiaries. Both the enlivening of economic activity and the reduction of credit risk encouraged growth of borrowing.

Picture 4.2. Loans to Domestic Enterprises, Private Persons and the Government, Quarterly Profile (million LVL)



Resource: Economic development of Latvia. Report, 2001

Some positive changes have occurred in the field of loan repayment deadlines and quality of credit portfolio. At the end of 1997, 44 percent of loans were short term, while at the end of 1998 only 33 percent were. By the end of 1999, their share dropped to 28 percent and at the end of 2000 it was 23 percent accompanied by a rise in long-term loans. At the end of November 2001, short-term loans were 22 percent of the total amount of granted loans.

The quality of extended loans at the end of September 2001 was as follows: 95 percent of all loans were evaluated by the banks as being standard, 1.8 percent as "close-watch" and only 3.2 percent as income non-performing (substandard, doubtful or lost)[5]. In compliance with the requirements of the Bank of Latvia income non-generating loans are secured by special savings. Therefore, such loans do not present a serious threat for stability of banks. Total amount of special savings has dropped from 2.9 percent at the end of 2000 to 1.9 percent at the end of September 2001 of the total amount of granted loans. The biggest receivers of loans by sectors at the end of September 2001 were: trade (25 percent of the total domestic loans), manufacturing (20 percent) and transportation, warehousing and communications (12 percent). Loans to hotels and restaurants and construction business went up especially fast during the period (by, respectively 160 percent and 98 percent). Banks mainly made loans increase of working capital of enterprises. Commercial loans were approximately 38 percent of the total granted loans in the first nine months of 2001. In turn, 28 percent of total credit portfolio was directed towards acquisition of fixed assets and financing of investment projects. The amount of mortgage credit in the first nine months of 2001 went up by 64 percent and the share in credit portfolio in total terms reached 14 percent.

[5] To compare: at the end of 2000, 5% of all loans were evaluated as income non-performing. In 1999 this was 6%, in 1998 – 7 percent,
in 1997 – 10 percent.

Table 4.7. Monetary Indicators of the Banking System of Latvia

	1997	1998	1999	2000	2001**
			(million LVL)		
Net foreign assets	705.2	552.2	516.9	536.9	658.7
Net domestic assets	269.0	506.7	634.2	739.0	832.6
Domestic loans	489.4	639.3	736.2	1057.3	1242.3
Government (net)	115.1	70.2	79.9	153.1	25.4
Enterprises and private persons	374.3	569.1	656.3	904.2	1216.9
Other items (net)	-220.4	-132.6	-102.0	-318.3	-409.7
Broad money M2X	871.3	923.0	997.2	1275.9	1491.3
Currency in circulation (less vault cash balances)	332.7	340.2	377.4	427.7	464.8
Private and enterprises deposits	538.6	582.9	619.8	848.2	1026.6
of which:					
Demand deposits	420.3	408.9	401.0	508.0	606.9
Time deposits	118.3	174.0	218.8	340.2	419.6
			(changes over the preceding period, %)		
Domestic loans	39.3	30.6	15.2	43.6	17.5
of which:					
Enterprises and private persons	77.0	52.0	15.3	37.8	34.6
Broad money M2X	38.7	5.9	8.0	27.9	16.9
Currency in circulation (less vault cash balance)	26.0	2.2	10.9	13.3	8.7
Private and enterprises deposits	47.9	8.2	6.3	36.9	21.0
GDP	15.8	9.6	8.6	11.2	...

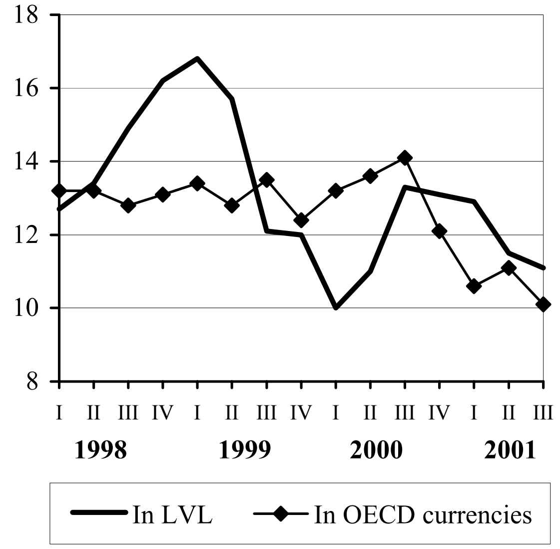
Resource: Economic development of Latvia. Report, 2001

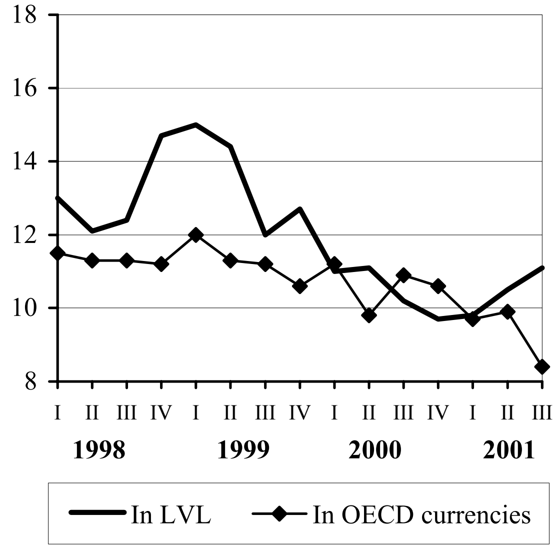
* Starting with January 2000, estimation of value of net foreign assets, other assets (net) and net domestic assets was changed due to the exclusion of non-residents' share in equity from the banking sector's foreign liabilities.

** end of November 2001.

Improvement of economic environment, low inflation and growing offers of loans promoted gradual reduction of interest rates on loans and extension of crediting deadlines (see Figure 4.2). Average weighted interest rate for short-term loans in LVL in November 2001 was 9.3 percent, for long term it was 10.7 percent (in OECD currencies it was respectively 11.4 percent and 7.9 percent). Long term borrowing and the reduction of interest rates is hindered by scarcity of long-term resources in banks (the majority of bank deposits are demand or short term deposits), high costs of raising resources and the risk that the lent capital will not be returned (no borrowing history, no collateral, etc.). Since March 17, 2000, the refinancing rate of the Bank of Latvia which signals to money market participants the upper limit of inter-bank market interest rates, is 3.5 percent per year. Before this (from April 25, 1997) it was 4 percent per year.

Picture 4.3. Average Weighted Annual Interest Rates on loans in Lending Institutions (quarterly profile, in per cent) Resource: Economic development of Latvia. Report, 2001





(short term) (long term)

Average weighted annual interest rates for short-term deposits in LVL in lending institutions in November 2001 were 5.7 percent and for long term, 6.7 percent (deposits in OECD currencies – respectively 3.0 percent and 5.1 percent).

5. Funding of Capital Investment in Infrastructure, Business Promotion and Human Resource Development with a View of Regional Dimension

5.1 LOCAL GOVERNMENT FINANCIAL EQUALIZATION SYSTEM

The equalization system of self-government finance plays the major role in the equal development of territories. The equalization of finance is necessary to create equal opportunities for self-governments in the fulfillment of functions defined by a law, because there are very rich self-governments, the wealth of which is affected by geographical and economical conditions but there are also the territories which are not able to fulfill their functions from of their income.

The equalization system of self-government finance was introduced in Latvia in 1995. The system contains regulations on financial necessity or expenditure need, as well as revenue equalization. The system is partially based on inter-municipal financing (horizontal equalization) and partially on the general state grants (vertical equalization).

The Council of Europe has listed recommendations for the development of systems of grants and equalization (Recommendation No. 4 R (91) 4). The Council of Europe recommends equalization of both expenditure and revenue. According to this recommendation, the expenditure equalization system should cover as much of the activities as possible, and be based on objective criteria, on which the individual local authorities have no direct control (art. 6).

The equalization of the self-governments expenditure and revenue is done for the three types of self-governments separately (Republic cities, rural (town and *pagasts*, *novads*) governments and district governments). The equalization of expenditure need and revenues is done in an integrated way, where as a focal point, comparison of the expenditure needs with the revenue side in each of the 578 self-governments serves. The self-governments with a revenue basis higher than 10 percent of the calculated expenditure need, contribute to the system. These self-governments contribute 45 percent of the mentioned surplus. The self-governments with a revenue below - 100 percent for the regions, 95 percent for the Republic cities and 90 percent for the towns/*pagasts*/*novads* of the expenditure need, receive grants from the Equalization Fund to bring them up to 100 percent, 95 percent and 90 percent coverage of their expenditure need, respectively. These ceilings mean that self-governments between 100 percent, 95 percent and 90 percent respectively, according to the type of the self-government and 110 percent of the expenditure need covered by the revenues, do not contribute or receive grants from the system (a so-called *neutral zone* with no payments paid or received).

In 2002, 58 self-governments are contributing to the Fund; 417 are receiving grants from the Fund, and 107 are in the neutral zone (Figure 5.2.).

5.1.1 Equalization of Expenditure

To carry out equalization of self-governments finance, first step is to determine the total financial (expenditure) necessity of self-governments in the country. The Union of Local and Regional Governments (ULRGL) and the Ministry of Finance do not have a common view on how to determine it.

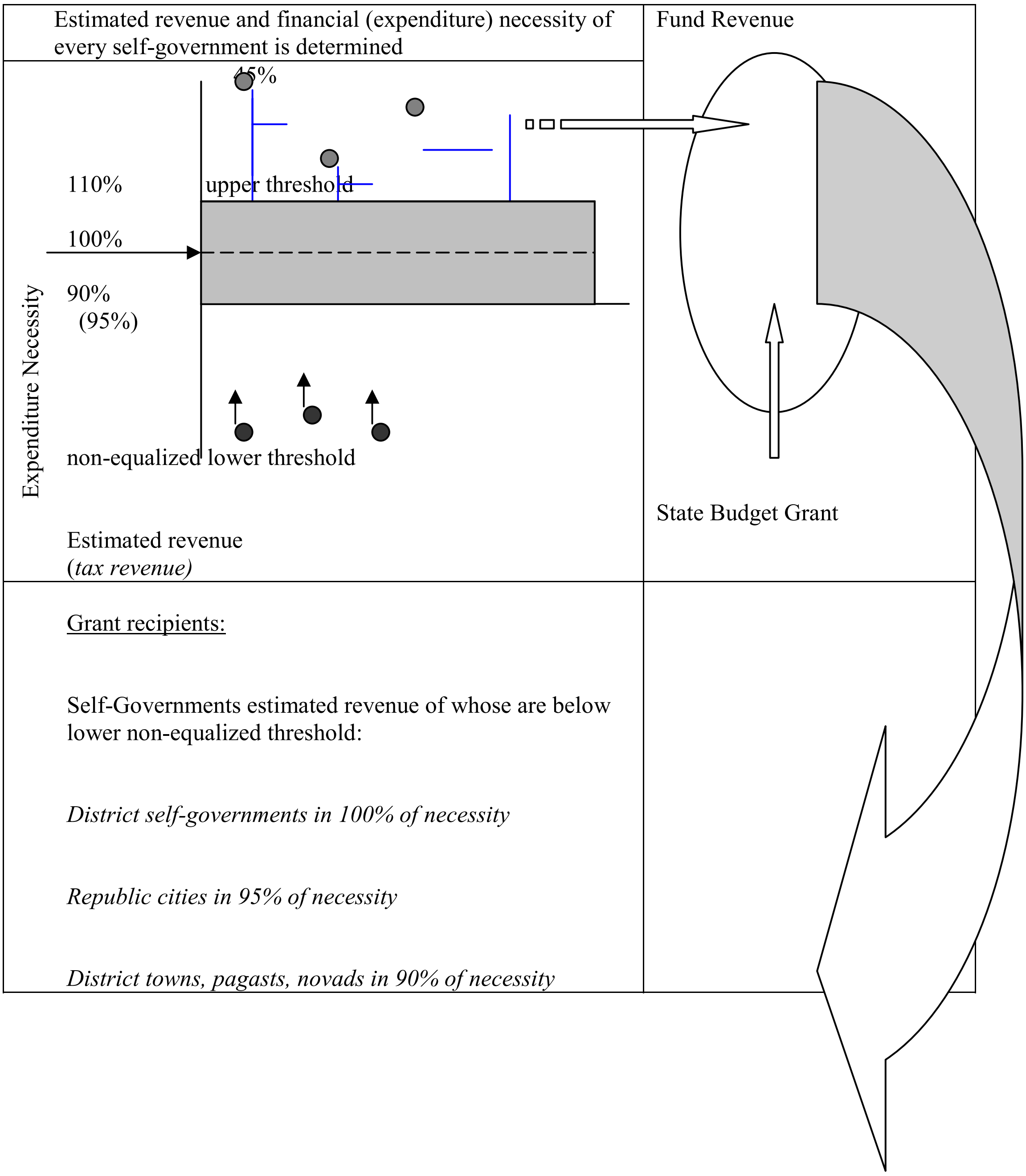
The Ministry of Finance adheres to Paragraph 8 of the law "On Equalization of Self-governments Finance", which stipulates that "total minimum financial necessity of self-governments in the economic year shall be calculated in the process of preparation of the annual state budget law and shall be included in the annual negotiation protocol of the Cabinet of Ministers and the ULRGL, taking into account the following aspects:

- Total financial necessity of self-governments planned in the budget preparation year;
- The forecast of the state macroeconomic figures of the economic year;
- Re-division of functions between self-governments, as well as between self-governments and the national government for the economic year;
- Priorities set for the economic year."

The experience of the last few years shows, that the Ministry of Finance applies the inflation coefficient on the previous year's financial necessity, only in order to determine the total financial necessity of self- governments for economic year. The ULRGL, however, when determining total financial necessity, refers to Paragraph 13 of the Section 1 of the law On Equalization of Self-governments Finance; i.e.: "total self-governments expenditure for carrying out those functions of self-governments, defined by the law "On Self-governments", and which are not financed by earmarked grants.

Since the current Equalization Law (1998), the ULRGL and the Ministry of Finance have not come to a consensus on the calculation of the total financial necessity of self-governments. Nevertheless, in 1998, a common opinion on methodology was reached, as a result of the economic crisis in Russia, the Ministry of Finance was forced to decrease the prognosis of personal income tax and financial necessity, since it was impossible to increase the amount of the state grant. In 2000, when determining financial necessity for 2001, methodology was accepted by both sides, but government could not find a possibility to increase the state budget grant, again.

Figure: 5.1. Equalization System of Self-governments Finance



The methodology prepared by the Union of Local and Regional Governments and the Ministry of Finance is as follows:

Financial necessity = (self-government base budget expenditure)
– (earmarked grants)
– (income from paid services)
– (capital investments)
+ (20 percent of investments)
+ (inflation).

The Ministry of Finance has determined the financial necessity for year 2001 to be LVL 202.6 million compared to the ULRGL figure of LVL 219.5 million. However, the Cabinet of Ministers and Parliament approved LVL 211.3 million as the amount of expenditure necessity. Issuing regulations for the Cabinet of Ministers, instructing them on the methodology of calculating financial necessity may solve the above-mentioned problems.

Based on the experience of the European countries, the total financial necessity could be calculated by the following method:

Total financial necessity = (expenditure of self-government budget)
– (earmarked grants)
– (income from paid services)
– (investments)
+ (20 percent of investments)
+ (inflation)
+ (loans for ensuring performance of self-government functions)
+ (expected salary increase)
+ (funding for new functions)

The system of equalization of expenditure need is based on the following main criteria:

1. Self-government group (Republic city self-governments; districts, district town self-governments, *novads* and rural self-governments);
2. The number of residents;
3. The number of children up to age of 6;
4. The number of young residents from ages 7 to 18;
5. The number of residents above working age;
6. The number of children in the children's houses;
7. The number of dwellers in the guesthouses and centers for the elderly.

The proportions of criteria (relative value) are calculated, taking into account:

1) numbers of self-government budget performance for a two-year period, prior to the budget preparation year;
2) the state budget priorities for economic year.

The proportions of criteria characterizing expenditures shall be used only in cases when determining the self-government financial necessity, and it should not be viewed as a norm for financing self-government functions.

The first five criteria are real, ”objective” criteria; i.e., those that self-governments can not influence, whereas Nos. 6 and 7 are so-called “quasi-objective” criteria, as these criteria are based on the number of children and the number of elderly people in centers for elderly (who have stayed there before January 1, l998). The last two criteria were developed in order to adjust for the way that some local authorities handle many of these children and elderly people, due to special huge service centers from the past communist system of service provision.

5.1.2 Equalization of Revenues

The equalization system is based on calculations of revenue from two taxes (personal income tax and real estate tax) prior to commencement of the equalization year, and self-governments pay or receive funds based on those calculations. If tax revenue appears bigger or smaller than projected, corrections of grants and equalization are not carried out afterwards.

It is interesting to note, that payments into the Fund are positively related to the per capita gross regional product, a measure of fiscal capacity. This is what is intended by the equalization formula. Payments from the Fund do not go to those self-governments with lower fiscal capacity, but rather to those with a higher expenditure needs, as proxied by the percent of population under and over the working age. This result is also largely intended by the current equalization formula.

Payments into the Fund mainly equalize fiscal capacity, while payments from the Fund equalize needs more. For all three years (1997-1999), wealth has been the dominant determinant of payments into the Fund, while fiscal needs have been the dominant determinant of payments from the Fund.

The current mechanism provides a high degree of equalization and it addresses what otherwise could be a significant problem, given the large fiscal disparities that exist among self-governments in Latvia. Whether or not such a high degree of equalization is needed or whether the degree of equalization is excessive, are difficult questions to answer. What degree of equalization is desirable depends, to a large extent, on the level of national solidarity and societal norms. The current degree of equalization may be considered excessive, if wealthier communities are equalized below the average of poorer communities. Excessive equalization may have the effect of reducing revenue mobilization efforts by those communities that are brought up to a national average. It may also discourage revenue mobilization by those self-governments that have to contribute to the Fund. An even harder question to answer is, whether the high degree of equalization may slow down overall economic growth of the nation by diverting resources from areas with higher economic growth potential to areas where fewer growth opportunities exist.

The Advantages of the Present Equalization System:

- The law of 5 March l998, is the first general law laying down the main principles for equalization, (i.e., these principles do not have to be discussed every year).
- The system provides for certain equal opportunities for service provision, although the system does not fully ensure this. The system links financial (expenditure) needs to the revenue (i.e., the possibilities for financing the present self-government tasks).
- The system is stable in terms of ensuring the major estimated revenue sources (i.e., state grants and personal income tax).
- The administration of the system is stable, well organized and transfers are made in a timely and regular manner.
- The system is based on a sound principal (i.e., money follows the number of varying types of residents and not specific institutions).

Disadvantages of the Present System:

- There is no sound methodology used for calculating the total financial necessity.
- The division of tasks and functions among different levels of government remains unclear.
- Districts are nearly 100 percent financed by grants and earmarked grants in the present system of self-governments finance. This reduces the link between the responsibility for the tasks and the responsibility for the finance.

- The current system has some deterrents for some of the self-governments to develop business and economy within their area. If local authorities are below a certain revenue level, compared to their expenditure level, they will not receive extra revenue at all, even if they can strengthen the tax base within their area or support the tax collection, (i.e., 100 percent equalization for these less wealthy self-governments). This problem will be deepened in a situation where self-governments would be involved and responsible for tax collection.

A preliminary analysis of the system of grants and equalization has shown, that the current system is not in a state of emergency, but there are a number of areas requiring improvements in short, medium and long-term.

- The current system of grants and equalization, and the reform hereof should be reviewed in context with the coming administrative territorial reform, and changes have to be introduced in parallel to this reform.
- In the current Latvian situation, funding of the system of equalization should be shared between the central government and richest local authorities.
- The maximum percentage share of payment of revenue to the Equalization Fund made by the "richest local authorities" should be considered for increase, and the highest percentage shares received by the "poorest local authorities" for decrease, in order to ensure sufficient finance of the system At the same time, this would ensure incentives for development.
- Equalization of the new regions should be done separately from other local authorities, in order to ensure transparency and accountability.
- The current, unclear division of tasks among the various government levels add to the problems in the existing system, and should be addressed in the future administrative territorial reform.
- Finance of the districts (regions) should be changed fundamentally, in order to provide for public revenue sources.
- Local authorities should be more directly involved in the development of the prognosis of tax income.

5.2 INVESTMENT FROM STATE BUDGET, SPECIAL SECTORIAL BUDGETS, OFF-BUDGET FUNDS

5.2.1 Investments

Since 1995, grants earmarked for investments may be obtained through the Public Investment Program (PIP). The PIP is prepared by the Ministry of Economy for the next three years, taking into account priorities, strategy of finances and directions of development of the economy, determined by the Government's Declaration for the period in question.
The following projects may be included in the PIP:

- Investment projects of the ministries;
- Investment projects of self-governments;
- National programs with long-term financing (more than one year);
- Technical assistance programs, directly related to the public investment projects.

In accordance with the governing legislation, proposals of the investment projects of self-governments should be submitted to the respective sector ministries, which have a responsibility to define sector investment priorities and rank their projects next to self-governments projects. Proposals of ministries, incorporating both national and self-governments projects, are submitted to the Ministry of Economy by April 1, which is responsible for reviewing proposals submitted and working out a draft working paper of the PIP. This is then submitted to the Cabinet of Ministers. To prepare and submit the proposal, self-government should carefully follow the methodology of preparation of investment project proposals, issued by the Ministry of Economy.

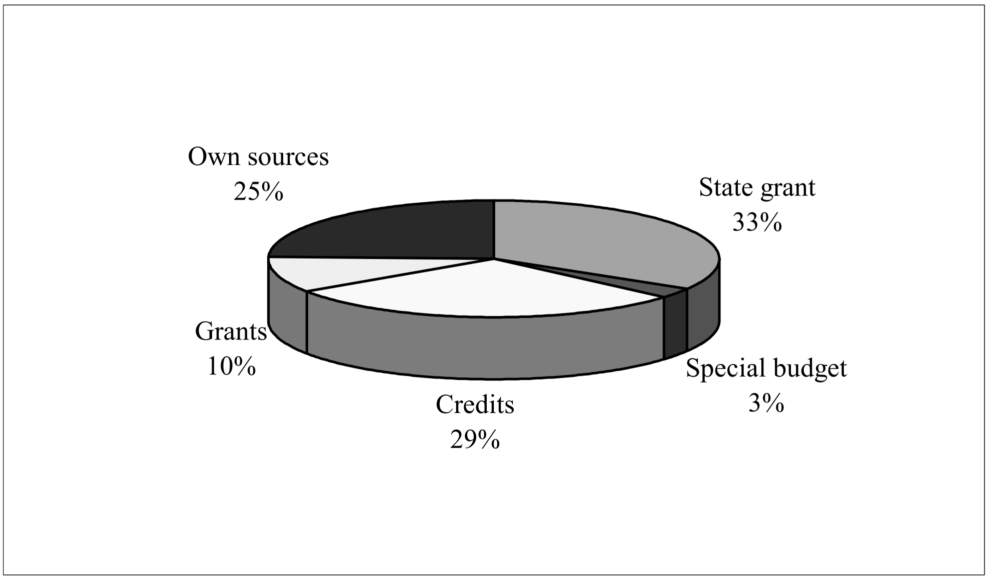
Nevertheless, the PIP is prepared every year for a three-year period. Funding limits are determined and are approved only for the coming economic year. During recent years, the state budget funds make up around one fourth of the PIP funding. The remaining share is made of loans, foreign grants and other financial resources (incl., co-financing share provided by self-governments).

The financing of local government investment projects from the central government basic budget goes up every year. In 1997, funds of the state basic budget in local government investment projects was LVL 2.8 million (in 1998 – LVL 5.9 million, in 1999 – LVL 9.1 million, in 2000 LVL 10.8 million). In 2001, the earmarked investment from the state basic budget reached LVL 14.5 million.

From 1995 to 2000, the structure of invested financial sources of the PIP has changed. If in 1995, the proportion of PIP projects financed from state budget was 50 percent from the total amount of invested finances, then in 2000 it has decreased up to 25 percent, while the use of the resources from loans increased rapidly. (In 2001-33 percent)

If the PIP is regarded as a source for financing self-government projects then in 2001 the biggest part was comprised of state grants at 33 percent (or LVL 14.5 million), loans at 29 percent (LVL 12.6 million) and public financial means at 25 percent (or LVL 10.6 million).

Picture 5.2. Financing self-government projects in PIP in 2001



On May 22, 1997, *Saeima* passed the law On the Assisted Areas to lessen socio-economic differences between rural municipalities, towns and regions. The objective of the law is to create opportunities for accelerated economic development in assisted areas and to facilitate establishment of equal economic conditions all over the territory of the state. The law spells out the basic principles for determination of the status of an assisted area and the means of regional development. It also stipulates establishment of the Regional Development Council and Regional Fund as well as the possibility to create local development councils and development funds. Several regulations of the Cabinet of Ministers and a series of instructions by the Ministry of Economy have been adopted to enforce the law.

Identification of the new potential assisted area is carried out in two phases. In the first phase, the potential assisted areas are identified on the basis of statistical data and recommendations of the Ministry of Environmental Protection and Regional Development (MEPRD) in regard to the territories where the development is restricted by regulations enshrined in effective laws and other normative acts. In the second phase, the potential assisted areas should work out their development programs, which are later reviewed by the inter-ministerial commission. On the basis of expert evaluation, the Regional Development Council selects the regions eligible for the status of the assisted area. The Cabinet of Ministers approves the list of territories that have gained the status of the assisted area. The status of assisted area is granted for a period of three years.

At the end of 1997, the Cabinet of Ministers granted the status of assisted area to 64 territories (first time) for a period of three years. In 1998, the document of the Cabinet of Ministers was supplemented with other territories. The status of the assisted area has been awarded altogether to 84 regions. The status was given to 5 regions, 9 towns and 70 rural municipalities (*pagasts*).

On June 28, 2001, the Cabinet of Ministers awarded anew the status of assisted area to 134 local governments (5 regions, 16 towns, 1 district and 113 rural municipalities).

5.2.2 Regional Fund.

Regional Fund was established in 1998. It is the main economic instrument for promotion of economic growth of assisted areas (for more information see section 4.2). Statutes of the Regional Fund say that the fund may have the following sources of revenues:

- State budget;
- Target payments and donations of legal and physical persons (also foreign and international organizations);
- Loans of foreign and international assistance institutions;
- Other incomes.

Although the Statutes of the Fund foresee several revenue sources, so far the only source of revenues has been the state budget in the form of the state basic budget and State Property Privatization Fund. According to legislation, the following payments may be funded from resources of the Regional Fund:

- Investment in the company (statutory enterprise) foundation capital;
- Interest payment on target loans that are successfully used in accordance with the submitted business plan;
- Lump-sum payments (payments for activities of economic education, additional payment for creation of new jobs, etc.);
- Investment subsidies;
- Partly – local development funds of assisted areas and work at development programs of assisted areas;
- Operational costs of the regional fund;
- Infrastructure development – in conjunction with a local government;

- Business promotion activities organized by a local government.

The Consultative Commission of the Regional Fund, comprised of delegated experts from the Ministry of Economy, Ministry of Finance, Ministry of Welfare, Ministry of Transportation, Ministry of Environment Protection and Regional Development and Ministry of Agriculture and from the Union of Regional and Local Governments, reviews and passes decisions in regard to every application/project submitted by potential beneficiaries.

The quality requirements for projects have become stricter in comparison with the preceding period of work of the Regional Fund (1998-2000). The projects aimed at creation of added value, economic diversification (alternative businesses) or the development of services are now eligible for funding from the Regional Fund. This means that project selection will be comparatively stricter and not all the submitted projects will get financing.

However, the quality of projects is becoming better, a result of both economic education activities and the fact that nearly half of all local governments were awarded the status of assisted area for the second time. This means that businesses and local governments have already accumulated certain experience in the development of business support projects.

5.3 LOCAL GOVERNMENT REVENUES AND DEBTS

One of the objectives of the operation of the government of the Republic of Latvia is to ensure the stability of finances. It is essential to implement up-to-date and internationally recognized financial policy to achieve this objective. One of the most important objectives of such a policy is the limitation of fiscal deficit of the state budget. Fulfillment of the state fiscal policy directly influences self-governments' budget revenue.

It is advised in paragraph 9 of the Charter, that the structure of funds of self-governments' is broken up in two broader categories: public funds and funds which they may freely operate with, within the framework of their jurisdiction, and "transferred means" or financial transfers.

Dynamics of budget revenue of Latvian self-governments during the period from 1995 to 2001 is reflected in Attachment No.1. The structure of self-governments revenue is comparable starting from 1997, since until that time income structure had been changed radically every year. After regaining independence, self-governments received revenue from various taxes, agreeing on distribution every year during negotiations. Distribution of grants and earmarked grants has been very diverse and is incomparable (Attachments No.3 and 4). Along with that, several money reforms have been implemented (from the USSR ruble to the Latvian ruble, then to the Latvian Lat), but the pace of inflation was sharp too. Thus, in 1991 subsidies and grants were allocated to district and town governments in thousands of rubles. Because of high inflation in 1992, the budget was approved every half year. Self-governments received earmarked grants as well as donations for payments of allowances for the poor, because of increased prices of energy resources. In 1993, differential subtractions for self-governments from state taxes (profit tax, personal income tax and value added (turnover) tax) were set, and donations for allowances for the poor were assigned as well. In 1994, for the first time, the equalization of self-governments finance was introduced, and has been changed every year. Only in 1998, was the long-term law On Equalization of Self-government Finance passed. In 1994, self-governments got subtractions from personal income tax and grants from equalization fund, as well as earmarked grants for investments.

The law On Taxes and Fees stipulates the forms of taxes and fees and describes the procedure of setting, collection and enforcing taxes, rights, duties and responsibilities of tax and fee payers and the tax administration. Appeal procedures for tax and fees- related decisions were also adopted.

The tax and fee system comes from state taxes, state fees and self-governments fees. Each tax should have adopted its own separate tax law and these laws should coincide with the general law. State taxes are paid into the state budget or, based on the prescribed distribution, split into the state budget and self-governments budgets, based on the respective tax law. None of the tax is stipulated as a self-government tax.

Since 1997, local governments and Republic cities receive income from real estate tax in the amount of 100 percent (until 1998, there were two taxes– land and property tax), 71.6 percent of personal income tax, 20 percent of lottery and gambling tax, a share of the excise tax on oil products, and 60 percent of natural resource tax.

The State Revenue Service administers personal income tax, except in three self-governments: Riga, Liepaja and Ventspils, which carry out individual administration functions. The tax revenue shares transferred to self-government budgets within the calendar year is determined based on the share coefficient of each self-government for personal income tax from total collected tax revenue in the state from tax payers' taxation year's revenue before two years.

The existing situation, when self-governments are not involved in the administration of personal income tax, does not facilitate interest of local authorities in the economic development of territory. Self-governments have no access to the operative information about actually collected personal income tax amounts imposed on the revenue obtained by residents of their territories. This, in turn, prevents self-governments to react in a timely way to the changes of economic situation in the territory.

Self-governments and the Union of Local and Regional Governments are sure, that self-governments should be involved in personal income tax administration since they have closer contacts with taxpayers. Ventspils, Liepaja and Riga authorities carry out separate personal income tax administration functions and their experience shows, that involvement of self-governments in the tax administration is effective. Self-governments have been considering the scope of personal income tax payers. Taxpayers without intermediates transfer the tax in the self-governments budgets; timely payment of taxes into the budget is controlled through reports submitted by the employers. It is possible to receive reports on tax payments received and tax debts to any date, as well as discipline of tax payments of every single employer.

Paragraph 3 of Section 9 of the Charter also says that at least a share of the financial resources of local power has to be obtained through local taxes and fees, the rates of which they have the right to stipulate within the limits determined by the law. Latvia has joined the mentioned point, however, none of the taxes is defined as a self-government tax in the Latvian legislation and self-governments have no rights to change tax rates. Until 1995, self-governments had been allowed to introduce local taxes.

As for the real estate tax, self-governments have the right to change the tax rate, but only by decreasing it. A number of self-government chairmen think it necessary to allow self-governments to change the tax rate by increasing it, too.

Since 1997, district governments do not have their own tax revenue. This does not favor their interest in economic development of their territory. At the moment, 90 percent of district government income is composed of grants and earmarked grants.

Since 1997, self-governments budgets are divided into a basic budget, which consists of tax and non-tax payments, transfers, and a special budget. Until 1997, financing for special budgets was formed as additional budget. The revenue part of self-government budgets has been increased and in 2001 is projected to be LVL 447.2 million, compared to LVL 341.0 million in1997.

Earmarked grants and general grants form around 26.0 percent of self-government revenue, out of which only around 7 percent are general grants.

In respect to the share of self-government revenue in the GDP, after 1996, self-governments total income has stayed relatively stable, in 1997 amounting to 10.1 percent, in 1999 dropping to 9.7 percent and in 2001 reaching 10.1 percent, again. The decrease in the 1999 indicator was mainly caused by the consequences of economic crisis in Russia.

While revenue has been relatively stable, the number of self-government functions have been significantly increasing due to recent laws and amendments passed to the existing legislation. Some of these functions are not performed at all, due to a lack of proper financing, as well as the limitations of obtaining financing through loans. Although not as brightly expressed, fiscal imbalance still exists.

Revenue structure differs in various self-government groups. There is a significant difference among the revenue in the various self-governments (horizontal imbalance). Tax revenue per capita in 2002 varied from LVL 21 in the poorest rural self- government to LVL 232 in most advanced (richest) ones. These differences to some extent are caused by the government's distribution system and, as a result, the structure of self-government revenues is uneven. Republic cities obtain the greater part of their revenues (70 percent) as a form of taxes. It should be reiterated, that district governments do not have tax revenue.

The share of non-tax revenue in budgets of all self-government groups is modest: in Republic cities, it is 2 percent; in towns, it is 6 percent; and in rural self-governments, it is 9 percent. Non-tax revenue consists of: revenue from entrepreneurship and property, fees, penalties and sanctions, etc. Self-governments only have the right to impose fees on the forms of activities stipulated by the law. Self-governments issue binding regulations when imposing every single fee, providing the following information: object imposed by fee; fee rate; fee payers; period of payment and payment term; scope of persons released from the fee or to whom payment discounts are applied; fee collection procedure and control mechanism.

According to the budget revenue classification, paid services correspond to non-tax revenue, however, analysis of the revenue structure shows it is necessary to separate them, as revenue is used to cover expenditure of provision of certain services. In Republic cities, paid services make up 7 percent; in towns, the figure is 11 percent; and in rural self-governments it is 4 percent.

Latvia has been ahead of many other countries in transition to the correct choice of revenue instruments for self-governments. The choice of both personal income tax and property tax as major sources of revenue for self-governments is appropriate because their tax bases tend to be relatively stable during business cycles of the economy. They are not easily exportable, and the link between the payment of these taxes and the benefits received by taxpayers from local public services tends to be a more identifiable.

Self-governments revenue is intended to cover expenditure of mandatory functions and voluntary initiatives stipulated by the law On Self-governments. Decision on use of self-governments revenue is made by the self-government independently, except the ones on use of earmarked grants.

Similar to the development of total revenue, public expenditure as a share of GDP has remained relatively stable since 1997, at around 10 percent of the total GDP. Comparing self-government expenditure in Latvia to that in other economies that have unitary intergovernmental systems, Latvia (10.6 percent) is placed close to other transition countries in terms of its self-government expenditure as a share of the GDP. This is well below local expenditure shares of 20 percent of the GDP and more, that prevail in the neighboring Nordic countries; the latter often being quoted as a model case for self-governance reform in Latvia.

Self-Government Debt

To implement economic and social programs, which require investments, self-governments may take out long-term loans. The right of self-governments to take out loans and issue guarantees for self-government entities is stipulated by the law On Self-governments Budgets. It is the responsibility of the Cabinet of Ministers to stipulate the procedure for self-governments to take out loans and issue guarantees.

The regulations of the Cabinet of Ministers state that self-governments take out loans by concluding a loan agreement with the State Treasury. The Minister of Finance taking in consideration self-government's application for implementation of certain project may approve another lender, in case its loan terms are more favorable than loan terms offered by the state budget. To implement Latvian National Environment Action programs, self-governments may borrow and issue guarantees for loans from the Environmental Investment Fund.

The Minister of Finance has established the Council of Self-government Loans and Guarantees Control and Supervision (hereafter referred to as the Council). The purpose of the formation of the Council shall be:

- To ensure compliance of self-government financial activities with the state macroeconomics policy;
- To provide opportunities to utilize loan capital (also the capital of external loans) for self-government debts;
- To preserve self-government assets and property;
- To complete the execution of the self-government functions and delivery of guarantied services to the inhabitants across the country;
- To coordinate and reduce the costs of self-government borrowing activities as much as possible.

Self-governments shall obtain the rights to take a loan or to provide guarantees only upon the receipt of the Council approval

This limits the rights of self-government to free access to local and foreign capital markets, which contradicts Paragraph 8 of Section 9 of the Charter. This paragraph is the only one not accepted by the Latvian Parliament.

Self-governments are not allowed to take long term loans if:

- They have not fulfilled conditions of an earlier concluded loan agreement;
- They have not submitted overviews determined by the state treasury;
- They or their enterprises have not paid taxes according to the procedure determined by the law.

Self-governments cannot issue guarantees to such self-government enterprises and companies, which have not paid the taxes as it is stated in the law, and which are insolvent or will be announced insolvent.

Self-governments can give guarantees only to those self-government institutions and enterprises where part of the capital of the corresponding self-government exceeds 50 percent, or to institutions, enterprises and companies established by several self-governments, where the sum of self-government shares exceeds 65 percent.

Self-governments can give guarantees at the same time envisaging making of savings in self-government budgets according to accountancy regulations.

Self-government enterprises can take loans either form Latvian commercial banks, or abroad, but cannot from the state treasury.

In 1997, self-governments took loans and gave guarantees in the amount of LVL 23.4 million. Of these, LVL 15.7 million were channeled for improvement of infrastructure; in 1998, the number was LVL 18.0 million from which LVL 12.9 million went for improvement of infrastructure objects; in 1999, the figure was LVL 21.6 million and in 2000 it was LVL 22.7 million.

5.4 EUROPEAN UNION FINANCIAL ASSISTANCE PROGRAMS

Structural Funds are currently one of the most significant instruments used for economic and social cohesion and provision of further development in the EU Member States. Latvia has expressed a strong wish to become a member of the EU and, by this, also to apply for the assistance provided by the Structural Funds and the Cohesion Fund.

Starting from year 2000, Latvia is starting to receive financial assistance from three pre-structural financial instruments

- **PHARE** (institutional building - 30 percent , approximation of legislation, investments in Aquis, social and economic cohesion 70 percent),
- **ISPA** (Instrument for Structural Policies Pre-accession),
- **SAPARD** (Special Assistance Program for Agriculture and Rural Development)

Pre-accession assistance to Latvia ~ 80 – 100 million EUR per year

ISPA ~30 – 50 million EUR

Phare ~30 million EUR

SAPARD ~21 million EUR

Institutional building ~10 million EUR

Introduction of Acquis ~5 million. EUR

Community programs and CBC ~ 5 million. EUR

Economic and social cohesion ~ 10 million EUR

5.4.1 PHARE

The PHARE National Program 2000 is around EUR 33 million. The National Program is made of a series of project fiches, which are designed for Institution Building needs as well as for Investments into the *acquis communautaire* and into Economic and Social Cohesion.

One of the crucial aspects of the PHARE 2000 program in Latvia is to assist capacity building for regional development at national and sub-national levels in Latvia. The importance of this project is highlighted by the need to prepare the country for the Structural Funds support.

From 2000 on, the EU also assists the candidate countries through Economic and Social Cohesion measures. These projects are also included in the National Program and amount to EUR 9 million to the two target regions of Latgale and Zemgale.

The Public Expenditure Management project (EUR 3 million) will aim at ensuring legality and maximizing efficiency in the utilization of public funds through strengthening different elements of the 'chain' necessary for effective public expenditure management.

The project for promotion of Social Integration in 2000 will focus on two priorities:

- The development of Latvian Language as Second Language (EUR 0.5 million);

- The development of mechanisms (Integration Foundation) for implementation of the National Program for Integration of Society, as well as on enforcement of pilot projects in order to demonstrate the capacity of the Foundation (EUR 0.6 million).

Other projects of PHARE 2000 will help strengthen border management, fisheries, drug control, upgrade of the Latvian Statistical System, as well as civil society (Special Civil Society Program Access: EUR 1.12 million). Latvia will also implement the Baltic Sea Cross-Border Co-operation Program (EUR 3 million), Community programs (EUR 2.27 million), the Supplementary Investment Facility Program (EUR 1.75 million).

Finally, Latvia will benefit from the implementation of a series of multi-beneficiary programs: EBRD Bangkok Facility Program (EUR0.75 million), Small Project Program (EUR 0.2 million), as well as TAIEX, Approximation of legislation, PHARE Statistical Co-operation, Program to support Business Representative Organizations, SME Finance Facility Phase 2 - Council of Europe Development Bank, SME Finance Facility Phase 2 - European Bank for Reconstruction and Development (EBRD), Joint Venture PHARE Program (JOP) and Administrative and Technical Assistance Program (ATA).

5.4.2 ISPA

The preliminary indications are that the allocation for environmental projects in Latvia, based on considerations of population size, surface area and per capita gross domestic product, will be approximately EUR 161 million over seven years, or an average of about EUR 23.4 million per annum.

The primary focus for ISPA in the environmental sector in Latvia are measures which enable Latvia to comply with the requirements of Community environmental law and with the objectives of the Accession Partnership.

Measures shall be of a sufficient scale to have a significant impact in the improvement of environmental sector. The total cost of each measure shall in principle not be less than EUR 5 million, although in exceptional cases, measures with a total cost less than EUR 5 million may be considered.

Community assistance under ISPA may take the form of non-repayable direct assistance, repayable assistance or any other form of assistance. The rate of Community assistance granted under ISPA can go up to 75 percent of the total cost of expenditure by public bodies. The Commission may also consider loans by International Financing Institutions to these governmental bodies to be equivalent to national public funds. ISPA funds may not be combined with the other Pre-Accession Instruments.

Preliminary studies and technical support measures may be financed exceptionally at 100 percent of the total cost (up to 2 percent of the total ISPA allocation), including:
Economic/financial feasibility studies; Environmental Impact Assessments; Reviews of design and project costing; Assistance in the preparation of tender documentation; Project management.

Priority projects for ISPA funding

A cost assessment was made for implementation of the most expensive directives in water, waste and air sectors. Considering that implementation will last until 2015, Latvia will need to invest about EUR 80 million per year. Planned investments for the period 1999 – 2006 are presented in table below.

Table 5.1. Planned Investments by Source of Finances and Sector (2000 – 2006)

	1999	2000	2001	2002	2003	2004	2005	2006	Total
Ambient air quality	0.74	0.35							1.09
Hazardous waste	1.38	5.24	7.02	10.44	10.47	0.00	0.00	0.00	34.55
Proposed landfill	1.33	14.36	13.82	17.51	19.00	23.15	0.00	24.31	113.48
Drinking water	38.60	50.74	27.24	20.55	22.07	26.84	24.35	28.51	238.90
Waste water treatment	38.60	50.74	27.24	25.07	26.93	32.91	25.84	34.44	261.77
Nuclear safety	0.71	2.27	2.40	6.05	3.15	0.91	34.85	0.91	51.25
Total	81.36	123.70	77.72	79.62	81.62	83.81	85.04	88.17	701.04
additional 5% from the total	0.00	0.00	3.89	3.98	4.08	4.19	4.25	4.41	24.80
Grand total	81.36	123.70	81.61	83.60	85.70	88.00	89.29	92.58	725.84

In EUR millions.

Water Supply/Wastewater

Priority investments in the water/wastewater sectors are:

- Wastewater collection, treatment and disposal projects implemented in the biggest cities with a population equivalent of over 25,000 and other agglomerations with a population equivalent of over 2,000;
- Service improvements for water utility consumers and connection of new consumers;
- Protecting surface water and groundwater serving as sources for drinking water; in this respect projects aiming at rehabilitation of contaminated land polluting groundwater resources should be considered;
- Protecting waters especially sensitive to eutrophication (e.g. lakes and reservoirs, Baltic sea);
- Limiting discharges of wastewater directly to lakes and rivers;
- Protecting trans-boundary waters.

According to potential project selection criteria defined in Chapter VI, the investment possibilities in the water sector have been considered. Investments for implementation of EU water sector legislation in the eight largest cities will be the main priority for ISPA financing.

Taking into account limited available state financial resources, particular attention is being paid to the ability of municipalities and municipal enterprises to co-finance investment projects.

As there is a significant number of small and medium size towns in Latvia, medium size towns have difficulties meeting minimum financing amounts required for ISPA eligibility (EUR5 million). Therefore, it has been decided to group projects on the basis of river basins. Such an approach would facilitate the implementation of EU water sector legislation in agglomerations with a population equivalent over 2000.

To date project groups have been defined along the following river basins, where investments in municipal water supply and wastewater treatment systems are proposed.

Table 5.2. Summary of the Estimated Accession Costs in the Water Sector

	Investment Cost	Operating Cost
	(EUR in millions)	(EUR in millions)
Urban wastewater	484 – 1,012	2.7 - 15.1
Drinking water	223 – 416	3.0 - 11.2
Sub-total	900 – 1,234	5.7 - 25.3
Nitrates	47 – 234	0

Grand total	947 – 1,515	5.7 - 25.3

Solid Waste Management

The priority actions concerning solid waste are:

- To create 10-15 regional municipal sanitary waste disposal sites for municipal waste;
- To ensure profitable circumstances for recovery and recycling of municipal waste;
- To separate dangerous municipal and clinical waste from total municipal waste flow.

According to potential projects selection criteria defined in Chapter VI, the investment options in solid waste sector have been defined. The construction of 10-15 municipal sanitary waste disposal sites and closure of old dumpsites (see the map "Solid Waste Management in Latvia" in Annex 1) will be the main priority for ISPA financing.

One of the key criteria for selection of solid waste management project is the officially expressed agreement of cooperation among the involved municipalities in the regions, establishment of inter-municipal institutions and their ability to co-finance investment projects. Elaboration of Environmental Impact Assessment in line with EU legislation is a precondition for project implementation. To date, as a rule, more projects in the solid waste management sector have been developed where strong commitment or leadership of municipalities are demonstrated.

Table 5.3. Summary of the Estimated Accession Costs in the Waste Sector

	Activity	Investment Cost	Operating Cost
		(EUR in millions)	(EUR in millions)
Hazardous Waste Management	Landfills	15	5
	Incineration	3	2
Municipal Waste Management	Landfills	125-140	2
	Collection System	47-63	3
	Composting	23-31	0.5
	Closure and Control/ Monitoring of Existing landfills	63-78	Not available
	Total costs	277-331	11

Hazardous Waste Management

The priority actions concerning hazardous waste are:

- Establish a landfill for disposal of HW;
- Establish system for HW incineration;
- Improve system for collection of data on HW producers and generated amounts of waste and on import and export of waste;
- Establish National Coordinating Authorities for management of HW system;
- Develop integrated HW management plans at state level.

According to potential projects selection criteria defined in Chapter VI, the investment options in hazardous waste sector have been defined. In cooperation with the Danish Environmental Protection Agency, the establishment of a system for HW incineration has been started. Construction of a hazardous waste landfill will be the main priority for ISPA financing for coming years. The project package will be designed completely according to EU criteria and procurement rules, as the ISPA will be the key co-financing source for the project.

Air quality

The priority actions to fill the gaps identified in the air sector are the following:

- The establishment of an ambient air quality monitoring program, which is currently under development;
- The adoption of testing methods for air quality;
- The development of criteria and technical requirements for assessment of air quality;
- The identification of zones where concentration limits of SO_2, NO_2, PM, Pb or ozone are exceeded;
- The development of municipal action programs for zones where the limits are exceeded (guidelines for their preparation, development of programs and their approval);
- The development of procedures for data collection;
- The regular testing of vehicle emissions for roadworthiness.

Since private sector funding will be involved in the implementation of priority actions in air quality sector, it is assumed that the Community assistance under ISPA would take the form of repayable assistance. Inclusion of revolving funds, which currently work in Latvia with PHARE means, is also proposed.

Table 5.4. Summary of the Estimated Accession Costs in the Air Sector

	Activity	Investment Cost (EUR in millions)
Ambient Air Quality	Monitoring	2
VOC Emissions	Vapor Recovery facilities (private sector costs)	23
TOTAL COSTS		25

5.4.3 SAPARD

Following the EU Commission's proposals, Latvia as an associated country of the European Union will have access to financial support for structural reforms in agriculture and rural development starting from the year 2000. SAPARD (Special Action Program for Agriculture and Rural Development) funding is available from 2000 to 2006. Joining the EU before the year 2006, Latvia may continue structural adjustments of economy receiving support from the EU Structural Funds and European Agricultural Guidance and Guarantee Fund (EAGGF).

In order to benefit from the SAPARD program, the Ministry of Agriculture is elaborating the SAPARD Program for Agriculture and Rural Development for Latvia. Elaboration of this Program is supervised by the inter-ministerial SAPARD working group. The group is comprised of representatives from the Ministries of Agriculture, Finance, Economy, Environmental Protection and Regional Development, Education and Science, Welfare, the European Integration Bureau, Foreign Assistance Program Coordination Directorate and the Union of local self-governments of Latvia.

The Latvian National Program on Integration into the European Union (NPIEU) and the National Development Plan (NDP) are taken into account in this Program. The priorities and objectives of the NPAA (National Program for Adoption of the Acquis) and the NDP comply with the priorities set in this program.

The global objectives of the program are: the implementation of the *Acquis communautaire* concerning common agricultural policy and related policies; competitive and sustainable agriculture; strong, sustainable rural communities and diverse and sustainable rural environment. This shall be achieved through the following specific objectives of the Program:

- Increase of competitiveness and farming income level;
- Increase of incomes of agricultural enterprises;
- Increase of competitiveness of processing sector and its compliance to EU requirements;
- Improvement of infrastructure of rural territory to bring it closer to urban standards;
- Creation of employment and more diverse employment structure in rural territory;
- Development and promotion of the methods designed to protect environment and maintain countryside.

On the basis of a survey in twenty-six districts, in which socio-economic partners (local self-governments, agricultural departments, branch offices of the Latvian Agricultural Advisory Center, the Latvian Farmers Federation, rural non-governmental organizations and advisory councils took part in the Survey) were involved, and with the approval of the SAPARD inter-ministerial working group, the following measures have been included in the Program:

Priority 1: Investments in agricultural holdings:

- Measure1.1: Modernization of agricultural machinery, equipment and construction of buildings.
- Measure1.1: Modernization of agricultural machinery, equipment and construction of buildings.
- Measure 1.3: Land repacelling.

Priority 2: Improvement of agricultural and fisheries product processing and marketing

- Measure 2.1: Improvement of agricultural and fisheries product processing and marketing.
- Priority 3: Development and diversification of economic activities providing alternative income.
- Measure 3.1: Development and diversification of economic activities providing alternative income.

Priority 4: Improvement of General rural infrastructure:

- Measure 4.1: Improvement of General rural infrastructure.

Priority 5: Environmentally friendly agricultural methods:

- Measure 5.1: Organic farming.
- Measure 5.2 Preservation of biodiversity and rural landscape.
- Measure 5.3: Reduction of agricultural run-off.

The vast majority of beneficiaries of the SAPARD Program are farmers, agricultural enterprises, rural entrepreneurs and processing enterprises of agricultural and fisheries products.

Table 5.5 Financial Plan of the Program: Projected Expenditure by Measure (2000 – 2006)

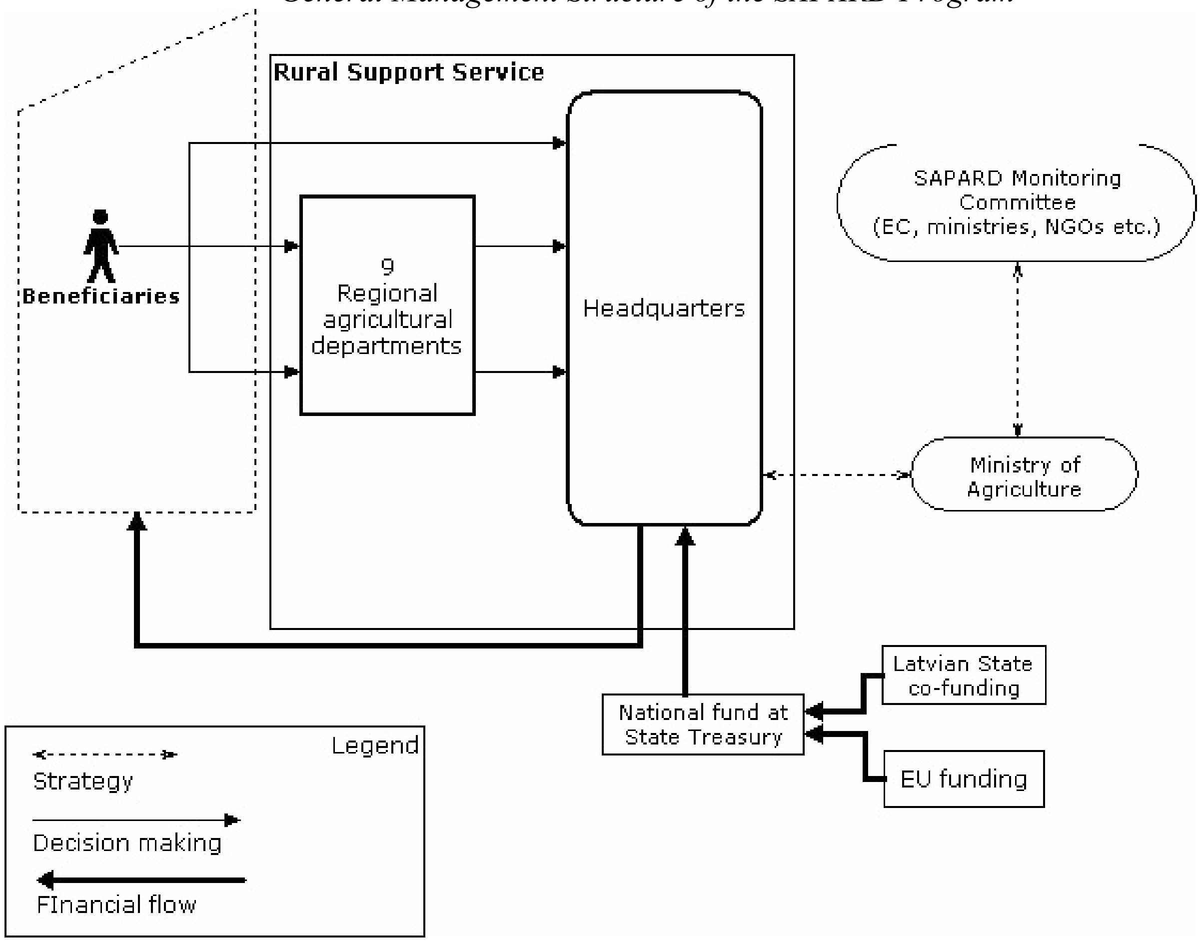
Measures	TOTAL	PUBLIC EXPENDITURE						Private Contribution	
		TOTAL		EU Contribution		National Contribution			
	EUR	EUR	%	EUR	%	EUR	%	EUR	%
1	2=3+9	3=5+7	4=3/2	5	6=5/3	7	8=7/3	9	10=9/2
Measure1.1: Modernization of agricultural machinery, equipment and construction of buildings	94,117,908	47,058,954	50.0%	35,294,216	75.0%	11,764,738	25.0%	47,058,954	50.0%
Measure 1.2: Reforestation of agricultural Land	12,199,984	6,099,992	50.0%	4,574,994	75.0%	1,524,998	25.0%	6,099,992	50.0%
Measure 1.3: Land repacelling	3,775,478	3,775,478	100.0%	2,831,608	75.0%	943,870	25.0%	0	0.0%
Measure 2.1:Improvement of agricultural and fisheries product processing and marketing	105,735,534	52,867,767	50.0%	39,650,825	75.0%	13,216,942	25.0%	52,867,767	50.0%
Measure 3.1: Development and diversification of economic activities providing alternative income	95,854,344	47,927,172	50.0%	35,945,379	75.0%	11,981,793	25.0%	47,927,172	50.0%
Measure 4.1: Improvement of General rural infrastructure	48,799,966	24,399,983	50.0%	18,299,986	75.0%	6,099,997	25.0%	24,399,983	50.0%
Measure 5.1: Organic farming	3,717,396	3,717,396	100.0%	2,788,047	75.0%	929,349	25.0%	0	0.0%
Measure 5.2 Preservation of biodiversity and rural landscape	3,252,721	3,252,721	100.0%	2,439,541	75.0%	813,180	25.0%	0	0.0%
Measure 5.3: Reduction of agricultural run-off	2,323,371	2,323,371	100.0%	1,742,528	75.0%	580,843	25.0%	0	0.0%
Supporting Measure 1: Training	9,804,580	7,843,664	80.0%	5,882,748	75.0%	1,960,916	25.0%	1,960,916	20.0%
Supporting Measure 2: Technical assistance	4,066,663	4,066,663	100.0%	3,049,996	75.0%	1,016,667	25.0%	0	0.0%
TOTAL	383,647,945	203,333,161	53.00%	152,499,868	75.00%	50,833,293	25.00%	180,314,784	47.00%

EUR (In 2000 Prices)

The Ministry of Agriculture delegates implementation of the program to the Rural Support Service, which acts as SAPARD Agency, covering both, functions of the implementing and paying bodies.
The SAPARD Monitoring Committee, the Ministry of Agriculture and the Rural Support Service shall administer the Program at the national level. Regional agricultural departments of the Rural Support Service shall be responsible for the implementation at the local level.
The following institutions will be represented in the Monitoring Committee:

- The European Commission,
- The Ministries of Agriculture, Finance, Environment Protection and Regional Development, Economy, Education and Science, Welfare,
- The Foreign Assistance Program Coordination Directorate,
- The European Integration Bureau,
- The Union of Self-Governments of Latvia,
- The Rural Support Service,
- The National Board of Fisheries,
- Other representatives of the socio-economic partners.

General Management Structure of the SAPARD Program



Investing in Regional Development:

Policies and Practices in Lithuania

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1. INTRODUCTION

OBJECTIVES AND RATIONALE

The objective of this paper is to assess the arrangements of additionality, concentration, partnership, programming, and transparency in the Lithuanian investment funding mechanisms.

In this paper:
Additionality - shall mean co-financing made by self-governments or final beneficiaries.
Concentration - the priority given in investment distribution to the correction of inter-regional disparities.
Partnership - consultation arrangements between levels of government and socio-economic partners in identification, design and implementation of investment programs, linked to *subsidiarity*, the assignment of responsibilities to the lowest efficient level.
Programming - compatibility of investment programs with coordinated multi-sectorial development strategies.
Transparency - clarity and availability of criteria and procedures for allocations.

While some of these principles entered the Lithuanian political agenda comparatively early (i.e.,, partnership and transparency), they were not widely applied to investment distribution so far. Others (i.e.,, concentration, additionality, programming) were not well known to the Governmental services until recently, when their application became a necessary part of Lithuania's preparations to absorb European Union structural aid. Though known about, they were rarely applied to investment planning either, until recently.

Why are these principles necessary? The simplest answer is that they are necessary because international donors, primarily the EU, require their application, or that some of them are enforced by the politicians, possibly at the expense of effectiveness. One may wish to recall the words of Benjamin Higgins and Donald J. Savoir, who said, "…nearly all less-developed countries are engaged in national development planning. In part, curiously enough, at the insistence of multilateral and unilateral donors who would never dream of recommending national planning for their own countries"[1]. Lloyd Rodwin indicated that "Despite the clarity of a nation's goals, political pressures can complicate and dilute the effectiveness of development policies. The issue of dispersal or concentration is an illustration of this. In the past, and even today, the pressure to satisfy political requirements has hobbled programs in Britain, France, and the United States (not to mention Italy and other countries of Western Europe)".[2]

As a result, some of these principles may contradict each other, especially concentration & programming vs. partnership, since concentration, as it would perhaps be argued by Rodwin, is unlikely to be achieved when partnership arrangements are very strong and when too many political actors need to be consulted. As Rodwin indicates "…although it is easier politically to advocate dispersal and then allocate resources otherwise (or allow such allocations to occur), the experience of France suggests that on occasion this process may be reversed. There, lip service has been paid to the ideology of concentration, but as yet this has imposed very few constraints on a far more permissive allocation policy".[3] What this, in fact, means is that it is politically impossible to argue for effective concentration of investment funds, as strongly supported by the theorists of

[1] Benjamin Higgins & Donals J. Savoir, (1995) Regional Development Theories and Their Application, Transaction Publishers, London, the UK.
[2] Lloyd Rodwin, Urban Growth Strategies Reconsidered in Niles M. Hansen (Ed.) (1972) Growth Centers in Regional Economic Development, The Free Press, New York, USA.
[3] Supra, Lloyd Rodwin, page 13.

the 'growth poles' (the supporters of the approach that the competitiveness of national industries in the Single European Market may only be achieved by assisting the development of most internationally competitive regions within the nation). If this is the case, do the partnership or transparency arrangements have sufficient meaning, once we presume that, the government will be able to enforce most effective investment distribution schemes by ignoring consultation results?

Despite some reservations, a lot of arguments may be presented in support of these principles. While it is apparent that the mechanisms of consultation may hinder effective concentration or inappropriately lengthen the cycle of programming, it may also be argued that the absence of such mechanisms allows the national or regional policy makers to make many more mistakes than they do. Obviously, besides (often) unjustified demands, local authorities, social partners or non governmental organizations may bring to the process of planning significant expertise and specific knowledge of the sectors, which the governments do not have. Apparently, besides lengthening the process of planning and bringing additional political pressures, consultations with local and regional governments may bring the national authorities a better understanding of local needs and situations. Finally, if democracy is a value, its principles should be observed even if some efficiency is lost.

Therefore, we may argue in this paper that it is not the application of these principles, but their inappropriate application which may cause damage and be unacceptable. In addition, the application of the principles and the extent to which they are applied should be adjusted, to the maximum extent possible, to the existing cultural and political environment, academic potential of decision makers.

Methodology

In assessing the effectiveness of concentration and programming, the authors shall refer to the theories of 'growth poles', 'central places' and 'cumulative causation'[4]. General assessment shall be given on the appropriateness of the theoretical material to the conditions of Lithuania, and it shall be argued that the theories of 'growth poles' and 'cumulative causation' are the most attractive tools for grounding the concentration of public investment under the severe scarcity of resources.

In assessing partnership and transparency, the authors shall present opinions of scholars on the effectiveness of decentralization policies and privatization of state functions. The key issue to be discussed is whether decentralization, wide ranging consultations or transparency impede the process of efficient programming and implementation of investment programs, that is the political impact of such consultations.

Finally, in assessing additionality, the authors shall use the empirical data, although the general point of view on why additionality may or may not be useful shall be provided too.

Programs

The programs and their funding mechanisms assessed in this paper can be divided into several major parts: the central government budget and the associated programs, and the municipal budget and the associated programs or funds. However, the municipal budgets have a heavy financial burden to maintain the basic infrastructure for public service provision and can rarely be expected to find any extra funds for development needs outside this sector. Therefore, without prejudice to the importance of local service delivery to region's development, the programs selected for the

[4] Other theories, such as those of bi modal production, dependency, etc., shall not be covered in this publication, since they are unlikely to have an impact on the explanation.

assessment are mainly funded by the central government or by international donor organizations, via the central government.

Only those programs are assessed in the paper, which, according to the authors' own judgment, have profound impact on the country or regions' development. 'Development' is understood not as a process of maintaining existing facilities, but as a process of expansion and economic growth. It should be born in mind that the paper is targeted primarily at regional development rather than national. However, since in a small country, as Lithuania is, there are very few materialized regional development programs (and some of those did not justify themselves), all respective programs shall be covered. A presumption shall be made that a program is important to regional development even if it is entirely national, since regional policy may be implemented by integration of regional needs into sector development strategies. Even more, the achievement of the economically and politically appropriate balance of regional and sectorial interests in the national development frameworks is probably the most important task of regional policy today.

The funds covered in this paper can be roughly divided into the following major categories: the State Investment Program (which has a distinguished special status), the general budgetary programs, the special budgetary programs, the off-budget funds (which are now limited to the social insurance system and is therefore of minor significance), and the European Union structural aid programs. Business development programs of the municipalities are also given a special attention.

The State Investment Program is a part of the budget and is primarily concerned with infrastructure development. It includes all projects of investment in infrastructure and some projects of capital maintenance of (and purchase of) property by governmental institutions. All relevant projects funded by the central government must be included in and monitored within this program. Municipal projects may also be included. An important feature of this program is that it includes the projects which are most frequently also reflected in other budgetary programs (general or special). As a result, investment in infrastructure, at least formally, is subject to 'double monitoring' arrangements, since the funds are expected to be monitored both in the framework of the specific budgetary program and in the framework of the State Investment Program.

The general and special budgetary programs appeared as a result of the comprehensive reform of the state budget undertaken in 1999-2000. Because of the reform, most of the off-budget funds were integrated into the budget and are approved in the budget. The Ministry of Finance, along with other budgetary programs, also monitors them. Thus, all national foundations with the impact on development, such as the Export Promotion Fund, the SME Development Fund and many others were transferred into special programs.

European Union structural aid has acquired tremendous importance in late 2000 – early 2001, since it appears to be the major source of governmental investment in transportation and environmental infrastructure, rural development, and development of lagging regions. These funds are also earmarked for SME development, export promotion, innovation development and other important measures. These funds, importantly, also require co-financing from the national budget and/or by private beneficiaries. By ascribing 25 to 50 percent of the total amounts of EU structural aid to co-finance this aid, the Lithuanian Government has connected almost all its investment resources with the EU funds.[5] The EU structural aid funds are, as a rule, a part of the state budget and have the status of a special program.

Finally, it is noteworthy that the municipalities have the right to provide business aid (within the limits defined by law). The aid may cover tax relief, but, most importantly for the purposes of this research, business development funds that may be used to support private

[5] In 2001, the national budget of Lithuania amounted to approximately 2 billion US dollars. The annual inflow of the EU structural aid makes up approximately 0,1 billion US dollars or 5 percent of the national (state + municipal) budget. According to the rules of the aid, the national government must co-finance it by contributing 25-50 percent to the total amount. As a result, around 5 percent of the national budget (Lithuania's own funds) are 'tied' to the EU aid.

enterprises located in a municipality. Many municipalities operate small business development foundations.

Sequence

This paper shall begin with brief description of the Lithuanian system of public administration and basic analysis of the regional disparities in Lithuania, in order to enable the reader to understand the administrative and territorial circumstances of country's development. Then the selected programs shall be assessed against their compliance with the principles outlined, in the light of respective theories.

After presentation of the theoretical material, a general evaluation of the compliance of funding mechanisms with the indicated principles and of the effectiveness of regional policy in Lithuania shall be given. An opinion shall be provided on whether Lithuania needs a regional development policy at all and, if yes, whether its coverage in existing investment programs is sufficient. In this respect, partnership arrangements requiring the strong involvement of regional and local actors can be regarded a part of regional development policy arrangements, since the reflection of local views in sector development programs is also a regional policy tool.

General policy recommendations shall be formulated in the last chapter.

This paper is not intended to provide universal coverage of development theories; neither does it pretend to be comprehensive in terms of assessment. However, the theoretical materials and arguments must be sufficient to substantiate policy recommendations and conclusions on the appropriateness of the investment distribution arrangements.

2. The System of Territorial Administration in Lithuania

In 1995, the present system of administrative-territorial units was formed. The former system of two levels and five categories with 581 administrative units was replaced by two levels and two categories, namely 56 municipalities and 10 counties. In the following years, the number of municipalities increased to 60. Only municipalities are genuine self-governing local authorities. Counties now do not represent local authority because the County Governors are appointed by the central government.

The institutional structure of local governments, the functions delegated thereto, their relations with central administration bodies, as well as the principles of their economic activities are governed by a system of legal acts. Local governments have a right to defend their legitimate interests in court. The administrative control over local governments is carried out by Government officials appointed under the procedure set in the law.

In terms of the decision-making, the functions of local governments are classified as independent, delegated (with limited self-governance), central (transferred to the local governments) and contractual, and in terms of the type of activity, into public administration and public services. The full list of municipal functions is presented in Annex 1.

By law, local governments have a right to plan and approve their (independent) budgets. Local governments only have the right to impose a small part of their own taxes. These taxes are assigned to the non-tax revenues. Local governments have the right to set the tax base and tax rate for local levies and for municipal budgetary revenue obtained for the services rendered. The two types of revenue comprise up to 10 percent of all non-tax revenue of local governments.

Sources of revenues assigned to local government budgets consist of tax and non-tax revenues and subsidies. The majority of revenues of local government budgets are generated by personal income tax and real estate tax. The size of the general subsidy is determined by the size of local government budget expenditures and the size of their tax and non-tax revenues.

The county governments are primarily in charge of agriculture and rural development. However, they also fulfill a number of other functions in the field of maintenance of cultural heritage, health and education, as outlined in Annex II. The county administrations do not have autonomous budgets. In county governments, personnel in charge of agriculture and rural development predominate.

3. Regional Disparities in Lithuania

According to the first (preliminary) National Development Plan of Lithuania,
“Internal regional disparities are manifested in several ways. Lithuania's population, economic infrastructure and economic activity are primarily concentrated in urban centers; i.e., Vilnius, Kaunas, Klaipeda, Siauliai, Panevėžys and some smaller towns (Alytus, Mažeikiai, Biržai, Kėdainiai, Telšiai). These towns feature better access to economic infrastructure, in particular transportation infrastructure, a more developed service sector, a higher rate of return on invested capital and a more qualified labor force. The geographical location of major cities and towns and their level of industrial development primarily determine the distribution of GDP, retail trade turnover, small and medium-size enterprises and employment in these counties. Vilnius and Klaipeda are Lithuania's main growth poles.

The economic infrastructure that links the periphery with the core and foreign markets is underdeveloped. The private sector in the periphery is less developed than in the core. The structure of economic activity in the periphery is dominated by under-performing inherited industrial capacities and a relatively weak service sector, while the structure of economic activity in the core is marked by inherited industrial capacities, modern industries and the service sector. The border districts are particularly marginalized by the concentration of economic activity in the core.“[6]

The measurement of regional disparities in Lithuania has been firmly based on two major indicators – GDP per capita and unemployment. Conditions of living, work efficiency and others may also be used, time to time, but without major impact on the identification of problem regions or the design of measures.

In terms of GDP per capita, discrepancies between Lithuanian regions are considerable and tend to further increase. In 1996-1999, difference in GDP per capita in the counties of Vilnius and Taurage (the richest and the poorest) increased 2.4 times. In three counties out of ten (Taurage, Siauliai and Marijampole), GDP per capita was below 75 percent of the national average, and one more county (Panevezys) will probably also soon fall into this category. According to the preliminary National Development Plan:

“There are substantial disparities in the distribution of GDP per capita in Lithuania. In 1997, in comparison with national share of GDP per capita (national average = 100), Vilnius County accounted for 121 percent, Klaipeda county 106 percent, and Panevezys county 101 percent of Lithuania's average. At the other extreme, Taurage county accounted for 65 percent of the average, Marijampole county 79 percent, Alytus county 84 percent, Siauliai county 87 percent, Telsiai county 88 percent and Utena county 90 percent of the national average. During the period

[6] Preliminary National Development Plan of the Republic of Lithuania, Lithuanian Ministry of Interior, drafted in 1999.

1996-1997, the share of GDP per capita increased in Vilnius (from 28.5 percent to 29.3 percent), Kaunas (from 19.5 percent to 20.2 percent) and Marijampole (from 4.2 percent to 4.3 percent) counties. During the same period, the share of GDP decreased for Klaipeda (from 12.4 percent to 11.9 percent), Siauliai (from 9.7 percent to 9.5 percent), Taurage (2.6 percent to 2.3 percent), Telsiai (4.5 percent to 4.3 percent) and Utena (5.1 percent to 4.9 percent). These trends point to increasing regional disparities within Lithuania."[7]

The 1999 data suggest that in three counties out of ten unemployment was below 7.5 percent (Vilnius, Kaunas, Klaipeda), in two counties – between 7.5 percent and 10 percent (Telsiai, Utena), in the remaining five counties – between 10 and 12.5 percent.[8]

In terms of gross earnings, in 1998 one county had 110 percent of the national average (Vilnius), three counties – between 100 and 110 percent (Utena, Telsiai, Klaipeda), three counties – between 90 and 100 percent (Alytus, Kaunas, Panevezys), two counties – between 80 and 90 percent (Marijampole, Siauliai) and one county – between 70 and 80 percent (Taurage).[9]

Specific data on tourism may also be useful. In 1998, the number of visitor nights per 1000 residents was over 500 in the county of Klaipeda, between 150 and 500 in the counties of Vilnius and Alytus, between 75 and 149 – in the counties of Utena, Kaunas and Siauliai, and less than 75 – in other counties.[10]

There are significant disparities in the distribution of FDI. In 1999, Vilnius County attracted about 61 percent of FDI, Klaipeda County about 13.1 percent, Kaunas county 12.2 percent. The least amount of FDI was attracted by Taurage and Marijampole counties (0.3 percent), Utena county (1.4 percent) and Telsiai county (1.8 percent).[11]

The distribution of small enterprises (less than 10 employees per 1000 people) is also uneven (the data for 1998). The greatest numbers of small enterprises are established in Panevezys, Marijampole and Telsiai counties (16 per 1000 people). The smallest numbers of small enterprises are established in Alytus, Taurage and Vilnius (10 per 1000 people). Yet, only an average of nine out of twelve small enterprises are active. The difference between established and active enterprises indicates the downturn of economic activity in certain counties. On average, three out of twelve small enterprises per 1000 people are not active. This indicator is greatest in Marijampole (8.7 enterprises per 1000 inhabitants of 16/1000 are not active), Utena (6.9/1000), Telsiai (6.4/1000), Siauliai (4.2/1000) and Alytus counties (3.8/1000). According to the enterprise survey of 1999, the greatest number of enterprises that increased their output during 1998 were based in Utena county (55.8 percent), Vilnius county (37.7 percent) and Siauliai county (31.7 percent). However, with the exception of Utena County, compared with 1997 the number of enterprises that increased their output went down considerably.

There are substantial disparities in production sales. In 1997, 22.8 percent of all production was sold in Telsiai county (primarily due to the oil refinery), 21.3 percent in Kaunas county, and 15.4 percent in Vilnius County. At the other extreme, only 0.7 percent of all production was sold in Taurage county, 3.5 percent in Utena and Marijampole, and 5.8 percent in Alytus.

In general, development predominates in the counties of Vilnius, Klaipeda and Kaunas. The county of Vilnius enjoys a 'privileged' position because of comparatively well-developed infrastructure, the status of the capital city, the supply of skilled labor, the presence of amenities and conveniences, which other regions may be (and, indeed, are) lacking. Klaipeda County enjoys benefits of having a large port and related infrastructure, due to which it is well established as a point for transit of goods. It may also boast of its comparatively well-developed amenities,

[7] Supra.
[8] The data in this passage is based on The Regions of the Baltic States (2000), Nordregio Report.
[9] The data in this passage is based on supra.
[10] The data in this passage is based on supra.
[11] The data in this passage and the passages below is based on the Preliminary National Development Plan, 1999.

municipal services, skilled labor, and infrastructure. However, the benefits are absorbed, while industrial clustering and the process of innovations take place primarily in the cities of Vilnius and Klaipeda and their suburbs. In fact, if the county of Vilnius is taken without the capital city, its macro economic indicators may be even worse than in most other counties, particularly due to severe under development of the South Eastern (ethnically Polish, Belo Russian or Russian) parts of the country. These issues are, however, quite unlikely to influence regional development policy, since, resources being scarce, the Government distributes its limited funds, if at all, on the basis of county level indicators only.

The poorest counties of Lithuania can be considered those of Taurage, Marijampole, and Siauliai (in which a lot of industries crashed, unemployment drastically decreased, and the overall situation deteriorated in 1999-2000). However, the counties of Telsiai, Panevezys, and Alytus have little to boast either. The situation in the county of Utena looks comparatively well due to high earnings in the Atomic Power Plant, which is to be closed in 2004. The multiplied effect on the county's economy of this station is now considerable, but the county is likely to suffer greatly after the closure of this object. Therefore, a lot of donor support is provided for this county already now, in order to avoid a social and economic shock.

Thus, the conclusion can be made that only the counties of Vilnius, Klaipeda and Kaunas have comparatively good economic development backgrounds and prospects, while in all other counties, and also in those same counties outside the cities of Vilnius, Klaipeda and Kaunas the economic depression, high unemployment and low wages, lack of public infrastructure and skilled labor are common features. Indeed, it would be incorrect to say that these territories have any potential to attract national or foreign investment, or to form industrial clusters, to develop R&D businesses. While the cities of Panevezys and Siauliai may have such a potential, subject to significant efforts and investment, all other cities in Lithuania are predominantly rural.

For the regional map of Lithuania, please consult the map below.

The Administrative Boundaries of Lithuanian Counties and Municipalities, 2001 (source: the Lithuanian Ministry of Agriculture).

4. Theoretical Foundations

4.1 ADDITIONALITY, CONCENTRATION & PROGRAMMING

Additionality

Additionality is a principle that was brought by the EU and applied to three EU structural aid initiatives – ISPA, SAPARD and PHARE Economic and Social Cohesion. For the EU, this principle means that a country as aid recipient should not reduce its own allocations for assisted sectors or programs, as a result of EU aid. Thus, the application of the principle of additionality means that the EU gets the assurance that its aid is additional to the national efforts, but not a replacement of them. In case of replacement, the real impact of the structural aid would be diminished and, in fact, EU would support some other, "hidden" objectives, by allowing the government to release extra funds elsewhere. Therefore, the requirement to apply this principle is well understandable.

Additionality may be understood, too, as the rule of co-financing. In this regard, it is applied in various programs in Lithuania, but is more limited in scope than in the case of the EU. There are few theoretical writings on the role of additionality in this sense. However, additionality is presumed to be a useful tool of increasing efficiency of public spending by attracting additional resources from regional and local actors. It should be noted, however, that the subjects of economy in Lithuania are usually insufficiently large and do not have a sufficient capital to acquire an interest in co-funding public infrastructure. Therefore, their contributions can rather be expected in business aid projects.

Concentration

Concentration is a controversial notion. To assess whether the principle of concentration is complied with, it is necessary to define what adequate concentration' means. However, even before proceeding to the definition, it is possible to point out that in Lithuania concentration of funds is rather sectorial than territorial. A tool of territorial concentration of funds is the system of equalization of municipal revenues and expenditures. An important framework is the PHARE 2000 Economic and Social Cohesion program, which committed EUR 14 million of EU funds and approximately EUR 3 million of central government funds to finance measures of business development, vocational training, consultancy, and infrastructure in four specific regions only. However, importantly enough, authorities soon realized that such a high concentration of funds in lagging (or even rich) regions could hardly be justified, since in poor regions a very limited demand is likely. In case of rich regions, it seems (so far) a better policy to announce nationwide competitions for project submissions, than to concentrate funds administratively. It should be borne in mind that PHARE 2000 ESC funds are mainly earmarked for private projects that require entrepreneurs' own initiative and creativeness.

At the same time, if we look at the data on the regional distribution of investment in the national programs, the largest share of funds shall almost always be committed to the three counties, in which the largest industrial centers are located: Vilnius, Klaipeda, and Kaunas. Such a distribution is not a result of regional policy, but rather a result of volume of needs, volume of initiatives, or other objective factors stemming from the fact that in these centers, there are a lot of residents, a lot of public infrastructure, and that the majority of innovative ideas come from here. Even in case of rural development programs (primarily, SAPARD), although it is not expected that the industrial centers shall benefit, it is widely expected that the richest farms shall absorb most of the aid.[12] The criteria for such a belief are the high minimum size of most of the SAPARD projects, and the fact that poor farmers will have no or little capacity to prepare the project itself, however simple would it be. Although some administrative assistance schemes for poor farms seem to be in place, and even some food processing enterprises introduce consultancy support schemes for poor farms, this is unlikely to change the situation significantly. Of course, there is no doubt that in case of the lack of proposals, the poorly-defined ones may also be funded, taking into account the institutional interest of both national institutions and the EU to absorb all the provided aid.

According to the theories of 'growth poles', 'central places'[13] and 'cumulative causation', the concentration of industrial activity, innovations, infrastructure and other factors around the industrial centers are natural phenomenon. The enterprises gain from the concentration, since there may be significant benefits from the localization and agglomeration economies, exchange of innovations between firms, availability of skilled labor, and, last, but not least, better local public services, more amenities. Public infrastructure is also likely to be more concentrated around the industrial centers, in view of the need to improve communications between points, in which industries and the consumers cluster.

According to Perroux, the founder of the 'growth poles' theory, "…economic space as an abstract field of forces leads to the notion of a vector of economic forces, and hence to the concept of growth poles."[14] Thus development always polarizes, leading to dominance and dependence.[15] Development poles, according to Higgins and Savoir, can be defined as aggregations of 'propulsive industries' able to generate and implement innovations – the key driving force of development.[16] The role of the 'growth poles', as these authors suggest, can then be defined in the following sequence:

- Development involves polarization.
- Growth poles are accordingly a "good thing", a source of dynamism in the economy, which generate spread effects somewhere, but not necessarily in their own peripheral geographic region.
- The principal role of growth poles is as a source and a diffuser of innovations.
- Therefore, growth poles should be encouraged to form and to play this role, even if this involves some measure of a domination/dependence relationship.
- A policy of selected decentralization (equilibrium poles) is not in conflict with this Perroux-style growth pole policy.
- Since investment decisions in propulsive industries are risky, temporary subsidization can be justified...[17]

Thus, the policy recommendation of the supporters of the 'growth poles' approach is to concentrate development efforts around the growth poles despite the relationship of domination and dependence, even though some degree of social tensions may appear as a result of such an approach.

[12] These farms will not, however, necessarily or predominantly be located in the three most prosperous counties, rather to the contrary.
[13] The difference between the theory of 'growth poles' and 'central places' is that the first one argues that pre conditions for development are in the poles themselves and the second one – that these preconditions are created by the periphery which surrounds the 'growth poles'.
[14]J.R.Lasuen, On Growth Poles, in Niles M. Hansen (Ed.) (1972) Growth Centers in Regional Economic Development, The Free Press, 1972, page 20.
[15] Higgins, Savoir.
[16] Supra.
[17] Supra.

Hirschman also seems to support this kind of solution. According to him, building infrastructure (which is essential for development) in under-developed regions is too expensive, and it is therefore better to promote growth poles in the hope that they will trickle down.[18] Trickling down presumes that at a certain stage of successful development, 'growth poles' shall reach the stage when return on further investment shall become lower and the attractiveness of peripheral regions greater - due to geographical constraints, expensiveness of land and labor force, increased information about other regions.

The theory of 'cumulative causation' further contributes to the discussion by asserting that, when a development gap between regions is formed, it shall further increase due to the competitive advantage of the 'growth pole'. The explanations of this phenomenon may vary and include demand-based strategies[19] or supply-based strategies.[20] Many authors attribute this phenomenon to the economies of scale, either internal or external. According to Armstrong and Taylor, for example, internal economies of scale are unlikely to predetermine such an outcome, and it is rather the external ones – i.e., economies of localization and agglomeration.

As the authors suggest, economies of localization cause clustering of firms in the same industry allowing greater specialization, increase in production efficiency, facilitates research & innovations, exchange of information and ideas, reduction of risks for both employers and employees. Economies of agglomeration, in turn, are understood as geographical associations of a large number of economic activities because of the concentration of major public or common facilities, such as urban transport and commuting, labor markets and labor availability, governmental services, local and commercial services, etc.[21]

However, the driving force of competitive and comparative advantage of the firms in the growth poles is considered innovation. There is quite a profound agreement on the role of innovations. Not only is a development pole defined as an aggregation of propulsive industries, which are supposed to base their activities on the innovative product, but also the very process of development is frequently associated with the creation and absorption of innovations. Regions producing innovative products may offer less competitive goods and thereby gain tangibly, while regions – producers of traditional goods face much tougher competition and must lower their prices accordingly. As Forslund and Johansson suggest, for example, "…a leading urban (metropolitan) region remains in the lead by initiating and developing activities which gradually spread to other locations in a hierarchy of urban regions".[22] On the basis of the empirical evidence from the Swedish regions, the authors find it possible to suggest that innovative products are first developing in the Malardalen region and then, after a certain period of time, production facilities spread elsewhere, while the leading region introduces new innovative products. There is no reason to disbelieve that the same would not happen elsewhere, rather to the contrary.

As already suggested above, the general policy recommendation of those supporting the 'growth poles' approach is to concentrate government support around the poles, in order to get maximum returns for the national economy. At the same time, it is widely accepted that regional policy may do no harm if it does not cause negative consequences in other (we may presume, more prosperous) regions and if it is not too costly. According to Armstrong and Taylor, persistent regional disparities may also bring undesired effects for the whole nation's economy, namely: social tensions, burdens for tax payers, excess demand for social infrastructure and public services in rapid growth areas, inflationary pressures on the whole country's economy, due to high wages

[18] J.R.Lasuen.

[19] These theories would tend to emphasize the role of exports of regionally produced goods, as well as intra regional consumption.

[20] These theories would tend to focus on factors of supply & production, often ignoring the demand.

[21] Armstrong and Taylor.

[22] Ulla M.Forslund & Borje Johanssen, The Malardalen – a Leading Region in Scandinavia and europe?, in Paul Cheshire, Ian Gordon (1995) Territorial Competition in an Integrating europe, Aldershote, UK, page 3.

in the growth poles (which are presumed to cause the increase in prices all around the country). Therefore, as the authors recognize, regional development policy can be and is an efficient tool of the overall governmental economic policy.[23] On the other side, however, there are serious arguments that governmental regional policy should not cause 'false incentives' for the firms, and that this policy should take into consideration how powerful the market forces and private choices of investors are. Diverting a firm from investing in a territory, in which it may gain a comparative advantage, may incur costs both for the firm and for the government (which will most likely subsidize the location of firm's facilities in a territory, in which the firm may achieve less than by locating somewhere else. Also, designing and implementing measures that have limited impact on the investors' behavior, such as measures limited to vocational training or local business support schemes, may result in spending the money without bringing a bearable result.[24]

As a result, policy solutions for concentration seem to be very difficult. On the one hand, if resources are scarce, dispersal of funds all around the territory or their concentration in the lagging regions may bring private enterprises' losses in internal or external economies of scale; measures targeted at inducing enterprises to locate in depressed regions are often costly and may cause 'false incentives' or financial burdens for the firms. In addition, the Government would lose quite significant public funds which could have been diverted elsewhere.

Several issues are, however, worth mention. First, there are comparatively 'cheap' measures. These are the promotion of linear development poles across the major trans European highways, if the construction of those highways were already foreseen and not induced by purely regional policy needs. As the empirical data suggest, across such highways economic activities tend to develop even without additional governmental support.

Secondly, the promotion of local entrepreneurship may also be useful and sometimes crucial. Training combined with small business loans or tax relief measures may bring desired effects.

Thirdly, administrative control of new industrial site construction may justify itself, as applied successfully in the UK. In this case, entrepreneurs are likely to locate their new industrial sites in lagging regions, if they do not feel that this may bring considerable business loses. At the same time, the possibility of issuing a permit for an industry's location in other regions should also not be ruled out for those whose businesses may suffer loses as a result of 'false location'.

Fourthly, territorial competition in public service provision and the quality of business services may (and should) be promoted. Finally, measures of infrastructure development and others should not be ruled out either providing that they are not too costly for the nation.

Programming

In the case of programming, the coherence of various sector and regional development documents is considered necessary for effective implementation of development policy. According to Conyers and Hills, "Planning is a continuous process which involves decisions, or choices about alternative ways of using available resources, with the aim of achieving particular goals at some time in the future."[25] Planning can be comprehensive (i.e., involve all aspects of development) or project related. There may also be integrated development planning for a certain geographical area that includes all sectors of activity in a certain geographically defined territory. Very importantly, "…the production of a 'plan' should not be regarded as the purpose of planning. The purpose of a

[23] Armstrong and Taylor.
[24] For example, according to Lloyd Rodwin, supra, incentives and controls are insufficient to divert the process of concentration, but just cause additional expenditures on the government's side.
[25] D.Coneyers & P. Hills (1984) An Introduction to Development Planning in the Third World, page 3.

planning exercise should be to achieve the particular goals which were identified or prescribed before the exercise began…"[26]

It may, however, be recalled that, according to Higgins and Savoir, comprehensive development programming, especially national, is regarded as more characteristic of the developing countries, rather than of developed ones. In both types of countries, it is frequently (though, of course, not always) based on recommendations or requirements of international donors (in case of the EU member states – on the structural funds' rules).

The vagueness of comprehensive development plans is a well-known phenomenon. According to Rodwin, who studied planning in UK, France, Turkey, US, and Venezuela, "The situation may appear to be all the more discouraging because development aims are defined obscurely in all the countries studies and not only in the United States, whose aims have scarcely been formulated at all. The British goals, for example, of encouraging growth centers and reducing unemployment in the lagging regions, are still so vague that they hardly provide an adequate basis for evaluating progress… The French goals appear to be more explicit… but conflicting national aims, not to mention pressures from other cities and regions, drain away much of the substance of this policy… The objectives in Turkey are far vaguer still."[27]

The same can be said of all, or at least some programs for the EU structural funds in the member states.[28] The member states present information reflecting the economic situation and formulate one or another set of measures, but tend not to formulate any indicators at all of achievement. These indicators, if formulated, refer instead to overall improvement than to improvement by a certain quantitatively defined number.

Consistency of integrated development planning is also in question. While keeping in mind that national comprehensive development strategies are not characteristic of developed countries, even regional integrated investment planning may seem to be difficult. A methodological question is whether a region, which has an administration with narrowly defined functions, can produce regular comprehensive investment plans for sectors, in which it does not have expertise. Whether such an approach is useful and feasible – is a big question. In addition to that, if we talk about investment planning, we should bear in mind a limited planning cycle (in terms of time). Comprehensive discussions are highly unlikely beyond the point of regions' own applications for funds (which cannot be extended to the whole regional development perspective, but are limited to the legally defined fields of competence), since the state budget is already subject to coordination with a plenty of managers of allocations at the central level. If both regional and national priorities and objectives shall appear to be vague, as it seems to be often the case in many countries, does it make sense to produce comprehensive regional documents for the purpose of investment planning? On the one hand, yes – since such documents may be useful as a source of analysis or as a basis for defining measures in cases when there is a full-scale commitment of the Government to aid one or some specific regions. However, it may appear to be the waste of funds if all regions are required to produce such documents regularly, often by contracting private consultancy firms.

4.2 PARTNERSHIP AND TRANSPARENCY

Even without referring to opinions of prominent scholars, we may conclude that the institutional set up, arrangements for partnership in decision-making and transparency of decisions, which a country is using to administer development issues may have a considerable impact on the results of

[26] Supra, page 14.
[27] Rodwin, page 9.
[28] The assertion is based on the experience of Algirdas Petkevicius, acquired during the internship in the European Commission in 2001.

development policies. According to Linn, "Evidence suggests that a state with transparent and effective institutions is associated with:

- Higher income growth, national wealth, and social achievements.
- Institutionalized democratic competition and meritocratic government.
- Policies and legal framework that are not "captured" by vested interests.
- A civil society and free media whose independent voice enhances the accountability to the government."[29]

According to Picciotto, "Development suffers as a consequence of corrupt, misdirected, or weak government, because only government can create an enabling environment for the development of efficient markets…"[30] However, "weakness of" or "corruption in" the government is not necessarily a result of deficiencies in the environment surrounding the government. It may also be a result of its ineffective organization, inefficient distribution of functions, lack of transparency and control, failure to understand the balance between government intervention and the market, as well as ascribing "wrong" functions to "wrong" organizations.

Putterman and Rueschmeyer suggest that, "The roles of states and markets in fostering economic efficiency are intricately intertwined. If this is true about economic growth in mature industrial societies, it is even truer when it comes to creating and maintaining the institutional conditions required for sustained economic growth."[31] Thus a major problem in this context is what a state should or should not do to improve the functioning of the market. If the roles are intertwined, it seems this is an argument for an 'embedded autonomy' rather than insulation of the government from private actors or local/regional authorities.

Esman points out that "When there is a choice, governments should promote and facilitate the development of market institutions and of vigorous private enterprises in the main productive sectors…"[32] He opposes the static argument that "…only the state is qualified to represent the general will or the common interests of the society…"[33], thus making it possible for the state to "…sponsor and, when necessary, undertake any activities that are essential…, including any that are critical to social and economic development."[34] According to Esman, governments are expected to create favorable conditions for development, including physical and social infrastructure.

Esman points out several organizational forms of implementation of government activity: contracting to private firms, setting up public enterprises, promoting voluntary associations, and transferring more powers to local authorities. Contracting to private firms means that "Instead of undertaking activities directly, governments arrange by competitive contracting for their performance by private firms, capitalizing on their presumed more efficient management capabilities, technical skills, operating flexibility, and freedom from political interference."[35] However, in this case, the monitoring and control becomes of critical importance because "In the absence of supervision, which can be a significant managerial cost, governments quickly lose control of contractors who are prone to cut corners in order to enhance profits."[36]

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[29] Linn, Johanness (2001) *The World Bank's New Approach to Good Governance: Promises and Risks* in *Transition Newsletter*, Vol. 12, No. 2.
[30] Picciotto, Robert (1995) *Putting Institutional Economics to Work: From Participation to Governance*, page 357.
[31] Putterman, Louis and Rueschmeyer, Dietrich, Eds. (1992) *State and Market in Development*, Lynne Rienner Publishers Ltd.
[32] Esman, Milton J. (1991) *Management Dimensions of Development: Perspectives and Strategies*, Kumarian Press, Inc., page 93.
[33]Supra, page 91.
[34]Supra, page 91.
[35]Supra, page 97.
[36]Supra, page 98.

Public sector enterprises, according to Esman, need more flexibility and freedom from political interference, in order to be effective, and voluntary associations should be promoted, although they are sometimes vulnerable to "faulty judgment, deficient skills, and financial abuses by their own leaders" [Esman] which can be remedied by introducing more transparency. Finally, regarding the activities of local governments, Esman indicates that, in his opinion, "…many activities of government are best performed by local authorities in the interest of efficiency, responsiveness and democratic control."[37]

However, whether or not the balance between government action and market forces exists, another important issue is the internal distribution of functions within the government. While issues of transparency and accountability have always been very important, during the last number of decades the issue of decentralization (and de-concentration) emerged as a tool to promote efficiency and democracy.

According to the World Bank, "It has been argued that decentralization improves governance and public service delivery by increasing:

- Allocation efficiency – through better matching of public services to local preferences.
- Productive efficiency – through increased accountability of local governments to citizens, fewer levels of bureaucracy, and better knowledge of local costs."[38]

The same approach is supported by Ostrom, Schroeder and Wynne. According to them, local officials are likely to have more local knowledge and are therefore better able to provide public services. They point out "…if the national government were to provide these services, it would attempt to provide exactly the same level of services to all areas, regardless of local demand."[39] In addition, "If each locality is allowed to chose (and pay for) the level of services it deems most appropriate, the overall satisfaction in the economy can be enhanced."[40] The authors also indicate certain advantages, which districts with specific functions may have. According to them, "When responsibility for the provision and maintenance of many different goods and services is assigned to a single set of officials, the temptation to increase the flow of immediate services to the clients by deferring future maintenance activities may be difficult to resist."[41] The authors also present a number of proposals on the possible distribution of functions between the central and local authorities.

What we can see from the above arguments is the fact that this state intervention in economy (or, one could say, the state economic policy) can only be efficient if, besides other factors, the division of powers between and capacities in the institutions are adequate. However, taking into account the particular nature of each specific state service (defense, public services, infrastructure development), different arrangements may be necessary because:

- These arrangements may require different degree of flexibility while flexibility of the government structures is not likely to fluctuate considerably.
- These arrangements may entail different collisions of interests between private firms, societal groups, which can only be addressed by introducing adequate legal and institutional arrangements.
- These arrangements may require different levels of specific expertise, local knowledge, etc.

[37] Supra, page 110.
[38] (2001) Decentralization and Governance: Does Decentralization Improve Public Service Delivery?, Prem Notes, the World Bank, No. 55, page 1.
[39] Ostrom, Elionor, Schroeder, Larry, Wynne, Susan (1993) *Institutional Incentives and Sustainable Development: Infrastructure Policies in Perspective*, page 182.
[40] Supra, page 182.
[41] Supra, page 183.

For these reasons, one institutional set up is apparently not able to solve all problems. While strict hierarchy is necessary to control defense arrangements or the provision of toll goods, much less hierarchy is necessary to address issues of private goods delivery. At the same time, while nobody argues that local governments should predetermine defense or monetary policy, a lot of arguments are presented that they are able to better manage the provision of local public services. At the same time, the setting up of districts with specific functions is likely to contribute to balancing spending preferences and avoiding the severe cuts of allocations for long term purposes to satisfy present day needs.

Due to psychological and administrative constraints which governmental institutions and each individual encounter, the balancing of interests within the government and between the government and other actors requires, indeed, different institutional arrangements.

5. General Conclusions on Investment Funding & Regional Development

5.1 STATE BUDGET / STATE INVESTMENT PROGRAM

As for the State Budget and State Investment Program, there were tangible achievements made by the Lithuanian Government in programming these funds in 1999-2000. For the first time after the restoration of independency in 1990, the national budget for 2002 shall be compiled for three years, not for a single year as previously done. The component of strategic planning has also been introduced, and the requests for funds must be based on strategic activity plans. All off-budget funds and international aid, which were earlier unaccounted for in the budget, are now included and accounted for. Monitoring and evaluation of the implementation of the budgetary programs were considerably strengthened. Quantitative indicators of achievement are to be raised, where possible, in order to justify requests for allocations. Last but not least, the personnel of the Lithuanian Ministry of Finance was considerably strengthened, in order to carry out regular evaluation. Internal audit units were or soon will be set up in each governmental institution with a sufficient number of employees, in order to conduct regular performance, financial and value-for money audits, depending on the arising needs.

It should be noted that:

1. In terms of concentration, neither the state budget, nor the state investment program is perceived as an instrument of equalizing the level of development in the regions. They are rather targeted at nationwide goals, such as business development, EU integration, membership in the NATO and information society development. Regional needs can be addressed in single programs, such as PHARE 2000 ESC, but not in the budget or the S.I.P. as a whole.
2. In terms of programming, both the State Budget and the State Investment Program now include measures justified in respective sector development strategies. Such arrangement has come as a result of the necessity to ground requests for allocations in the strategic activity plans of the governmental institutions, which must and do take into consideration sector development strategies produced by those same institutions. Sometimes regional strategies may also be taken into consideration directly; i.e., not through the sector development programs. However, such cases can be few, if any.
3. In terms of partnership, cooperation with the managers of allocations always takes place. However, taking arguments of local and regional participants into consideration is subject to

the presence of viable justification. Consultations are not mandatory, and the refusal of the central government to agree with one or another comment or request is not subject to appeal, but may be subject to lobbying possibilities. However, lobbying by mayors or county governors (or private organizations) can only be effective if significant political support at the national level is generated. Cases when allocations considerably increase or decrease due to political lobbying of local / regional participants are few.

4. In terms of transparency, the procedures used look transparent. Information is published on the Internet or can be obtained from the Ministry of Finance or respective institutions.
5. In terms of additionality, arrangements vary and contributions from local and regional partners, including private ones, are often valued. However, mandatory requirements to contribute are more characteristic of EU structural aid schemes. Recently, they were also introduced to the State Investment Program. They are also applied to various business support schemes.

Some specific arrangements may be assessed separately, namely local employment initiatives and special business support programs.

5.1.1. Local Employment Initiatives

Concentration

The local employment initiatives scheme directly contributes to the reduction of local employment disparities. First, the scheme is concentrated in few local areas with high levels of unemployment. In 2001, only ten local authorities out of sixty local authorities were selected to participate in the grant scheme. Second, according to the requirements of the scheme, every grant recipient should establish a few working places. However, the financial volume of the scheme is too small to reduce local disparities in income and employment in a significant way.

Programming

The local employment initiatives scheme is programmed on the basis of the National Employment Creation Program for 2001-2004, as well as the Local Initiatives Concept Paper. The latter document is updated every year by the Ministry of Social Affairs and Labor together with socio-economic partners.

This scheme was not coordinated with any national or EU program. Although the local employment initiatives scheme is meant to prepare Lithuania for its participation in the EU Social Fund, in practice, it overlaps the SAPARD program. Under both programs, grants may be provided to farmers or agricultural companies for similar eligible activities. Insufficient emphasis is placed on vocational training in this scheme.

Partnership

The scheme has a favorable impact for the development of tripartite cooperation between the government, employers and employees. According to the mentioned Order, an equal number of employers, employees and government should be represented in the project management commissions on the local level. Also, local authorities should be represented in these commissions.

In practice, however, local authorities tend to be the most active partners, whereas it is difficult to involve social partners on the local level – sometimes there are no employers or employee organizations on the local level or they are not involved in any activity. However, in a few districts social partners participated in the activities of local commissions.

On the other hand, the scheme has favorable impact for the development of cooperation between the public and private sectors. Most grant recipients of the 2001 scheme were private business enterprises. This scheme allows coordination of the objectives of business expansion and unemployment reduction on the local level.

Additionality

A grant under the local initiatives scheme may not exceed 65 percent of the total project costs. The remaining 35 percent of the total project cost should be financed from private sources of project applicants and their partners. In practice, project applicants are contributing up to 60 percent of their own revenues to the project implementation.

Transparency

The management of the scheme is insufficiently transparent. Although some local authorities complained about the selection of ten local authorities in the scheme, this decision seems to be justified for the concentration purposes taking into consideration the relatively low financial volume of the scheme.

Social and economic partners are involved in the activities of the scheme both on the national and local level. Their representation is contributing to the development of tripartite co-operation on the national and local level.

However, there are some conflicts between the Implementation Document and the actual practice. For instance, only legal persons can in practice receive assistance from this scheme, albeit according to the Implementation Document both natural and legal persons are entitled to receive assistance.

Some local management commissions (namely in Pakruojis, Pasvalys, Joniskis), which are responsible for checking the eligibility of project proposals and evaluating project proposals, submitted few ineligible projects to the Project Monitoring Committee. However, this shortcoming may be explained by lack of knowledge and experience in project selection, rather than purposeful decision. To remedy this shortcoming, the Committee proposed to train responsible staff of the territorial labor exchanges.

On the other hand, the Project Monitoring Committee did not sufficiently take into consideration the opinion of local management commissions in the final project selection and approval stage. It was proposed to delegate more responsibilities to the local level, e.g., in the project selection stage.

Although the management of the scheme is defined by the Implementation Document and its annexes (eligibility and selection criteria), they are not very detailed. The Project Monitoring Committee under the National Labor Exchange, during its meeting, recommended to improve the management procedure of the scheme by:

- Unifying interim and final reports;
- Making project eligibility and selection criteria more detailed;
- Clearly defining the project financing procedures;
- Coordinating project objectives with the regional development and local business programs;

- Making the functions of local management commissions and the Monitoring Committee more concrete;
- Improving the Contract between the territorial labor exchanges and grant recipients.

5.1.2. Special Business Development Programs

Concentration

Business support programs are very centralized by their nature and they have no objective of reducing regional development disparities. Emphasis is placed on the concentration of thematic nature.

However, the business support programs have the objective of promoting local and regional business development. The Ministry of Economy attempts to take into account local and regional development needs by allocating co-financing for the preparation of local and regional development projects. The SME Program is most orientated towards local and regional development. In the 2001 SME Program, USD 0.15 million was allocated for the preparation of regional and special programs and their implementation; USD 0.16 million - for business information, training and advisory services; and USD 0.94 million - for the development of business incubators.

CASE STUDY: IMPLEMENTATION OF THE BUSINESS TRAINING AND CONSULTING PROJECT IN SIX REGIONS

The SME Development Agency is coordinating the implementation of a business training and consulting project at the regional level. About USD 0.1 million was allocated for the implementation of this project in 2001. Six non-target regions (Vilnius, Kaunas, Siauliai, Panevezys, Alytus and Telsiai), which are not eligible to receive business support from the PHARE ESC 2000 program, were identified to participate in the project. Few service providers, who will deliver subsidized consulting and training services to business subjects, will deliver the project at the regional level. Training and consulting services will be provided on the following subjects: how to establish an enterprise, how to manage bookkeeping, how to pay taxes as well as such subjects as financial analysis, control and management, labor law. Business start-ups will receive an 80 percent subsidy for training and consulting services, while operating businesses – 70 percent. The remaining percentage of the price will be covered by private businesses.

Programming

Business development programs are prepared according to the strategic planning methodology, which is approved by a joint decree of the Minister for Finance and the Minister for Public Administration Reforms and Local Authorities, and taking into consideration various sectorial development strategies and programs. The SME program is prepared according to the SME strategy, the Export program – the Export strategy, the Industry program – a number of strategies and programs, including strategic documents for industry, quality development, hazardous waste, business innovation.

Partnership

Neither local nor regional authorities are directly involved in the management of the business support programs. The Lithuanian Association of Municipalities, which is represented in the Business Development Council, only indirectly represents local interests. Therefore, the business development programs have not affected the development of partnership between national and sub-national levels of government to a great extent. Since the volume of financial resources for local development projects is limited, individual local authorities tend to promote their own projects and compete rather then co-operate among themselves. The case study below describes the proposal to decentralize the management of the SME program.

CASE STUDY: DECENTRALIZATION OF THE SME PROGRAM

> In 1999, to better take into account regional development needs, the Ministry of Economy proposed to decentralize the management of the SME program. The proposal included the allocation of about 30-40 percent of all funds earmarked for the SME program for the ten counties as well as the establishment of ten regional business development councils for the management of decentralized SME programs at the county level. However, the decentralization has not been carried out. First, according to the Ministry of Economy it was not legally possible to channel financial resources earmarked in the budget of the Ministry of Economy to the county administrations. Second, the contracting size of the SME program in 1999 and 2000 reduced the commitment of the Ministry of Economy to the decentralization process. At present, the management of the SME program remains centralized.

The business support program contributed to the development of partnership between the public and private sectors to a great extent. The three main business associations (the Lithuanian Confederation of Industrialists, the Association of the Chambers of Trade, Industry and Craft and the Lithuanian Association of Banks and the Lithuanian Confederation of Business Employers) are represented on the Business Development Council. The business support programs are perceived by the private sector as the main funding opportunity for their business development.

Additionality

The size of a grant from the business development programs usually does not exceed 50 percent of the total project costs. The balance must be financed from the applicants' own resources.

For instance, applications in the type of activity entitled "Participation in, and Organization of, Business Exhibitions" are co-financed by the Ministry of Economy at the rate of 50 percent (for the participation in, and organization of, international exhibitions) or 30 percent (for the participation in, or organization of, national exhibitions). The applicants should cover the remaining percentage of expenditures.

However, the implementation of some projects is 100 percent financed from the business development programs.

Transparency

The management of the business support programs is sufficiently transparent. The Ministry of Economy takes into consideration needs of main partners during the breakdown of financial resources into different types of economic activities. However, some business representatives argue that the Ministry of Economy favors needs of medium-sized and larger enterprises and does not take into consideration needs of micro and small enterprises during this process.

Second, the main business associations and other partners are involved in the decision-making process through their representation in the Business Development Council. However, individual partners sometimes tend to promote their own projects. It is recognized that the Confederation of Lithuanian Industrialists, which represents the interests of most large enterprises, is a key player. Moreover, some ministries are not represented on the Business Development Council, including the Ministry of Education and Science responsible for, among other things, for research and development.

Third, the business support programs are managed according to the guide and other documents containing detailed procedural requirements. Many documents, which are relevant to the management of the business support programs (including actual decisions of the Business Development Council about the award of grants to particular business subjects), are available on the Internet.

Despite the relatively transparent management of the business support programs, some business associations complain about the lack of transparency during the project selection process. The Ministry of Economy argues that, often projects proposed by business subjects, fail to meet eligibility criteria specified in the guidance documents. For instance, the Ministry of Economy made a recommendation to the Business Development Council to reject an ineligible project proposed by a business company run by a chairman of the Economy Committee in the Parliament of Lithuania.

5.1.3. Equalization of Municipal Revenues

Although the state budget is not directly perceived as an instrument for regional policy, the *Seimas* approved in 1999, the Law on the Methodology of Determination of Municipal Budgetary Revenues which establishes the indicators determining the amount of revenues of local government budgets as well as the level of the need for their equalization. It defines the ratio of the size of municipal budgets to the size of the national budget. In this case, municipal expenditures are linked with the general state of the state economy and of the national budget revenues. Mechanisms of equalization of both tax revenues and expenditures are applied. The indicators determining the amount of budget revenues for a local government and revenue equalization are approved by the *Seimas*, after they have been coordinated with the Association of Local Authorities in Lithuania.

Key financial indicators are established by way of negotiations between the central government represented by the Ministry of Finance and local government represented by the Association of Local Authorities in Lithuania (the so-called vertical equalization). There is also a horizontal equalization, which refers to the adjustment of differences in the structure of tax revenues and expenditures between local governments themselves. However, this redistribution of revenues is not sufficiently equitable and regular.

Another important problem is the difference between financial capacities of local governments and the functions to be carried out by them. The functions delegated and the resources appropriated for carrying out such functions have always been an issue of debates between the central and local governments, the reason of which is the lack of methodology for calculation of the need for resources to carry out such functions.

5.1.4. General Conclusions

There are, however, some problems too. The lack of competent staff, the outflow of personnel to the private sector, etc. are serious obstacles. Due to problems of competence, senior governmental servants are often unable to understand the role and scope of strategic planning or one or another specific program. For this reason, it often happens that the intensity of strategic planning, even in such institutions as the Ministry of Justice, exceeds all imaginable levels, with units in charge of pure legal review being required to draft and re-draft their strategic activity plans numerous times.

5.2 EU STRUCTURAL AID PROGRAMS

Concentration

While SAPARD and ISPA funds are not regionally concentrated, PHARE 2000 Economic and Social Cohesion Initiative is entirely focused on development needs of four specific regions – counties of Klaipeda, Taurage, Marijampole and Utena. However, since very significant amounts are allocated for limited types of measures, such as business consultancy and vocational training, the absorption of these funds is likely to create a ‘crowding out’ effect; i.e., an oversupply of governmental aid. In order to use all funds, the government and the consultancy firms have either to increase fees without increasing output, or to ‘squeeze’ rather than offer the respective aid to subjects of economy.

Programming

In the field of programming, coherence was not yet achieved. SAPARD allocations are based on the Rural Development Plan prepared by the Ministry of Agriculture, ISPA allocations – on specific projects, PHARE ESC allocations – on a specific National Development Plan or Single Programming Document. However, the National Development Plan is regarded not only as an instrument for planning PHARE funds, but also as a planning exercise to create a reliable basis for planning the EU structural funds after Lithuania’s accession. In addition, this plan is often misunderstood as an instrument of regional development policy.

Partnership

According to the Regional Development Act, all projects, which involve EU structural aid, must be coordinated with the partners. However, in reality this practice is applied to a much more limited extent, for the following reasons:

- Social partners and municipal authorities usually have a very limited level of knowledge on the subject.
- The process of planning already involves a lot of participants from the central government and the EU, and is generally very heavily politicized. The involvement of additional

partners may require time and patience. When deadlines are usually pressing, this can hardly be done.

- The central government itself has very limited administrative capacities, both in the field of planning and implementation.

As a result, the procedures of the 'Regional Development Act' have never been applied in practice. Consultations take place, but to a more limited extent. Nevertheless, taking into account the three factors outlined above, this is already a very considerable achievement. The national authorities should not be blamed for a limited application of the consultations' mechanisms, since it would lose efficiency if they were fully applied.

Transparency

The rules of transparency are well observed in the case of all EU structural aid. However, it is necessary to notice that procedures are sometimes so complicated that it is dificult to explain them. Another important problem is heavy political pressure, due to large amounts of funds. Because of this pressure, central executive government may be unwilling to reveal information to comparatively un-influential partners until the final decision is passed.

Additionality

A general conclusion can be formulated that the principle of additionality is expected to be strictly applied to all EU structural aid programs – primarily ISPA, SAPARD, PHARE Economic and Social Cohesion. However, in fact, this is more applicable to Structural Funds for after the accession rather than the pre-accession funds. Therefore, in case of pre-accession funds, its implementation is not controlled, and its application is limited to the funds committed to co-financing, not to the entire sectors of support. In case of ISPA, a 50 percent national public contribution is required, and in case of SAPARD – a 50 percent national public contribution to the total amount of public (EU + national) funds and a 50 percent private (aid recipient) contribution to the total amount of public and private funds for the project. In the case of PHARE Economic and Social Cohesion, the government contribution amounts to 25 percent and the private contribution, if applicable, to 15-25 percent.

5.3 MUNICIPAL BUSINESS DEVELOPMENT FUNDS

Lithuanian local authorities in accordance with the legislation have the right and possibilities to establish a fund for promotion of and support to SME development in their territory. Every year the number of local authorities providing support to the SME sector is increasing, and that shows that local politicians understand the importance of SME development. Local initiatives, already to a certain extent, influence the socio-economic situation in the municipalities. According to statistical data, the unemployment level is higher in those regions where local government institutions have no municipal SME support funds.[42]

At the same time, there are still a number of problems and obstacles hindering further development of this system in local authorities:

[42] Rewiev on SME Development, p. 11 http://www.svv.lt/index2.php?article=195

- Lack of financial recourses that Lithuanian local authorities can provide for support of SMEs. In present economic situation, where the most of local authorities have large debts and low income level, all the municipal budget is usually spent for provision of main services for inhabitants, like heating, water supply, waste collection or transport;
- The lack of financial independents at local level, when local governments has limited rights to collect and levy own taxes, makes the situation even more complicated.
- Strategic planning is still underdeveloped in the public administration at the local level. A large number of Lithuanian municipalities still do not have any strategic documents for SME development. Consequently, with a lack of experience in making priorities, the support provided is often accidental, scattered, has little impact an general situation of local economy and is difficult to evaluate.
- Legal activity of enterprises in using the funds is considerable. The main reasons for that are the insufficient economic potency of SME sector in Lithuania in general lack of own capital, high costs of registration of all the documentation necessary for application of funds.
- Local businessmen are not organized enough in associated structures, which could be equal partners for municipalities in the planning and implementation of support to local SME sector.
- Insufficient coordination between different institutions providing support to SMEs.
- Overall lack of capacity within municipal administrations and especially in the small and medium enterprises. This reflects in the insufficient knowledge of possibilities for acquiring support from local, regional, state or international funds.

In order to overcome those problems, local, regional and state authorities will face serious challenges in the near future trying to make support to local business more sufficient.

On a central level, it is important to increase financial independence of local authorities by providing them with the right to levy and collect local taxes and fees. By this, municipalities could better plan their incomes, determine local priorities and support certain prioritized areas of business. The municipal taxation policy would become more flexible and effective.

Local authorities should attach more importance to strategic planning process. Both general, long-term plans for socio-economic development of municipality, and more specific SME development plans, should be prepared.

As municipal SME support funds are managed by local authority and the main task of those funds is to strengthen local business, the criteria of concentration is not so applicable for this flow of funds. For the same reason when speaking about the coordination of recourses with any programs at the central level, the term programming is difficult to use. In any case, better coordination of actions taken by local authorities and support provided from Ministry of Economy, Lithuanian Development Agency for Small and Medium-Size Enterprises and other important participants could contribute to more complex and effective actions. Cooperation between different municipalities and regional programs are the tools that are still too little used.

On the other hand, if we speak about the programming of any public expenditures and revenues, this principle of planning in Lithuanian state institutions has been set as a priority. Local authorities are recommended to use this principle as well. In some municipalities, there is a tendency to pass financing of SMEs from the fund to the system when the special program in municipal budget provides this support. This transition in local government sector should continue in the future in order to achieve more targeted use of public money. Independently of which way of support municipalities would choose (fund or programs in the budget), most important is that the action taken by municipalities results in the positive change of general business environment in the municipality. The role of municipal administration is to create and coordinate a well-functioning system in municipality, where different public and private institutions would assist entrepreneurs in establishing and developing their business. Municipality could, for example, be responsible for the creation of a flexible system of taxation, provision premises. Business information centers could provide consultations, training and information, banks would be responsible for provision of credits etc.

For municipal politicians, it is important to decide which form of support is the best one in his concrete territory. For example, providing SMEs with favorable credits is a very complicated activity, demanding a lot of bureaucratic procedures, financial and human recourses. This is not a typical function of municipality. Therefore, maybe it is better to leave this for the bank sector, which has more capacity and experience in doing this. Municipality on other hand could support SMEs by covering the interests for commercial credits. Support to creation of business information centers had become an important issue, and this process should continue because those centers are able to overtake a major part of the work that now is done by municipal administration. For this action, both municipal recourses and support from the Ministry of Economy should be coordinated.

Municipal funds are sometimes supposed to provide co-financing to different projects implemented in the local area. This is especially important for participation in projects financed from EU pre-accession funds. Pooling of EU or other international support and municipal recourses in the area of support to local SMEs increases possibilities to follow the criteria of additionality, to attract bigger recourses and to create projects of larger impact. Local enterprises should also be obligated to provide their own co-financing supplementing support from municipal funds. In this way, businessmen can demonstrate real interest in investments and further development.

Partnership criteria in planning and implementation of support have been taken more and more into account by local authorities. The socio-economic partners, in this case, local businessmen or representatives of associations, are participating in commissions responsible for provision of support to local SMEs, and their general role is increasing. Partners are also being invited to participate in development of municipal programs targeted towards improvement of the business environment. This process has to be continued because not all of local authorities have implemented the principle of partnership. Only active participation of the business community can guarantee that the actions taken by municipal administrations receive the right target groups and are effective. At the same time, municipalities by consultations and training should support businessmen in creation of associated structures, which would better represent their common interests.

Transparency in the decision-making process in all the questions related to SME support, is an issue, which is closely linked to the above mentioned problems. This criterion is already followed by most of local authorities. All the decisions made by the commissions, responsible for selection of applications to be financed, are usually published in local newspapers or other local media. Sometimes applicants are even allowed to participate in the commission meetings. Lithuanian legislation provides citizens the right to observe Council meetings where important decisions concerning the support to SME sector are usually made.[43] Further involvement of different interest groups, especially businessmen associations in the work of institutions responsible for steering of SME support funds would contribute to the transparency in the early stage of decision-making process.

Training and increase of institutional capacity within municipal administration should remain as one of the priorities. Both civil servants and local politicians has to be trained in methods and tools how to cooperate with SMEs, how to involve communities in decision-making process and how to make the process as transparent as possible. At the same time, local authorities

[43] Law on Local Government, article no. 7

are still very important initiators and providers of training and technical assistance to local enterprises and this work should be continued.

6. Conclusions and Policy Recommendations

The assessment and the presented theoretical material give rise to the following conclusions:

1. The principle of additionality is strictly enforced in the EU structural aid programs. Recently it also acquired more importance in the State Investment Program, other measures of investment allocation. However, private contributions to public investment schemes in the field of infrastructure can hardly be expected at this stage.
2. The principle of concentration can be understood in different ways. If, however, we adopt the theories of 'growth poles' and 'cumulative causation' as the background for justification of territorial investment distribution, it is not advisable for Lithuania to concentrate significant funds in backward regions, unless there is a persuasive economic justification. Given the scarcity of funds, 'growth poles' are to be promoted via nationwide schemes, which would not exclude lagging regions either from competitive participation. Concurrently, limited funding to local entrepreneurship, training and infrastructure development can be considered.
3. The principle of coherent programming was introduced to the Lithuanian system of investment planning, with the adoption of the multi-annual strategic planning approach in the national budget. Some uncertainties exist in the field of planning documents for the EU funds, since these do not always fit to the general system, due to different (sometimes unclear) status. This situation may be justifiable, however, since only the first steps have been taken by national authorities in this field. Another important thing to notice is that the appearance of integrated and coherent regional or national investment plans is not a mandatory part of the investment distribution process and is not always applied by the developed countries.
4. The principles of partnership and transparency are applied widely to all investment distribution instruments. However, only in a few cases are they mandatory. Usually discretion is allowed for the central government in defining arrangements. This approach seems justified, taking into account weakness of administrative structures in charge of planning and limited time available for a planning cycle.

7. Annexes

ANNEX I. FUNCTIONS OF MUNICIPALITIES, AN EXCERPT FROM THE LAW ON LOCAL SELF-GOVERNMENT (VERSION OF 25.09.2001).

Article 5. Functions of Municipalities

1. Functions of municipalities shall, according to their discretion to adopt decisions, be divided as follows:

   1) Independent. A municipality shall exercise such functions in accordance with the competence granted by the law, obligations to its community and for the interests thereof. When implementing the said functions, a municipality shall have the freedom of initiative of decisions, their adoption and enforcement, and shall be responsible for the fulfillment of the said functions;
   2) Assigned (of limited independence). When implementing this and other laws, as well as other legal acts adopted on the basis thereof, a municipality shall exercise such functions taking into consideration local conditions and circumstances;
   3) State (delegated to municipalities). These shall be State functions delegated to a municipality, taking into consideration interests of the local population. The said functions shall be delegated by the law and implemented in compliance with legal acts. When implementing the said functions, a municipality shall have the freedom of adoption of decisions, as prescribed by the law;
   4) Contractual. The implementation of such functions shall be based on contracts.

2. Functions of municipalities shall, in accordance with their type, be divided into public administration and public service provision functions. Public administration functions shall, in the manner prescribed by the law, be exercised by the municipal council, municipal controller, the board, the mayor, municipal administration, as well as other agencies, services, local government employees who are granted the rights of public administration in the territory of a municipality by legal acts or decisions of the municipal council. Public services shall be provided by service providers established by municipalities or other legal and natural persons under contracts concluded with municipalities.

Article 6. Independent Functions of Municipalities

The following independent functions shall be established:

1) Pre-school education;
2) Additional education and, vocational training of children and youth;
3) Informal education of adults;
4) Provision of meals at institutions of pre-school and general education;
5) Establishment, maintenance of agencies of social services, and co-operation with public organizations;
6) Support of health care of the local population from the municipal budget;
7) Organization of people’s employment, acquiring of qualification and re-qualifying, public and seasonal works;
8) Participation in ensuring public order and peace (creation and implementation of local programs on crime control and prevention, requesting the services of police agencies

operating in the territory of a municipality, as well as including public organizations and residents in the said activities);
9) Development of physical training and sports;
10) Organization of tourism and recreation;
11) Establishment of territories protected by a municipality, declaring objects of nature and cultural heritage of local significance the objects protected by the municipality;
12) Creation of conditions for the development of business and promotion of such activities;
13) Other functions, which are not assigned to state institutions.

Article 7. Assigned Functions (of Limited Independence) of Municipalities

Assigned functions (of limited independence) of municipalities shall be as follows:
1) Organization of general education of children, youth and adults;
2) Organization of transportation to schools and to places of residence of pupils of rural schools of general education, who live far from schools;
3) Protection of the rights of children and youth, ensuring of education of children under 16 years of age who live in the territory of a municipality, at schools of general education or other schools within the education system;
4) Provision of social services and other social support;
5) Creation of conditions of social integration into the community of the disabled (invalids, persons with total disability);
6) Preparation and implementation of health programs of municipalities;
7) Primary personal and public health care;
8) Control of compliance with the prohibition or restriction of alcohol and tobacco on exterior means of advertising;
9) Territory planning, implementation of solutions of a general plan and detailed plans of the territory of a municipality;
10) Promotion of general culture and ethno-culture of the population (establishment of museums, theatres and other cultural institutions and supervision of their activities), establishment of public municipal libraries and supervision of their activities;
11) Ensuring of the requirements of construction and architecture;
12) Maintenance and protection of the landscape, immovable cultural values and protected areas established by a municipality;
13) Supervision of the use of construction works, issuance within the limits of competence of permits to build, reconstruct, repair or demolish construction works;
14) Planning of the infrastructure, social and economic development, preparation of programs related to the development of tourism, housing, small and medium enterprises;
15) Management, use and disposal of the land and other property, which belong to a municipality by the right of ownership;
16) Organization of heating and drinking water supply, as well as wastewater collecting and treatment;
17) Management of State aid to acquire housing, provision of social housing;
18) Improvement and protection of environment quality;
19) Approval of sanitary and hygiene rules and organization of the control of compliance with the said rules, ensuring of cleanliness and tidiness in public places;
20) Development of municipal waste management, organization of secondary raw materials collecting and processing, as well as establishment and exploitation of waste dumps;

21) Maintenance, repairing, surfacing of roads and streets of local significance, as well as ensuring of traffic safety conditions;
22) Organization of transportation of passengers by local routes;
23) Provision of addresses (names of streets, buildings, construction works and other objects located in the territory of a municipality and belonging to it by the right of ownership, numbers of buildings and residential houses as well as flats) and change thereof;
24) Ensuring of rendering of burial services and organization of maintenance of cemeteries;
25) Participation in the formation and implementation of regional development programs;
26) Establishment of the procedure of rendering of trade and other services in marketplaces and public places;
27) Issuance of permits (licenses) in cases and manner prescribed by the law.

Article 8. State (Delegated to Municipalities) Functions

State (delegated to municipalities) functions shall be as follows:
1) Registration of acts of civil status;
2) Management of registers assigned by the law and furnishing of data to State registers;
3) Organization of civil protection;
4) Organization of fire-prevention services of a municipality;
5) Participation in the management of national parks;
6) Calculation and payment of compensations (heating expenses, cold and hot water expenses, government-supported passenger services and others);
7) Organization of free-of-charge meal provision for children from low-income families at all types of general education schools;
8) Calculation and payment of social benefits;
9) Management, use and hold in trust the State land and other State property assigned to a municipality;
10) Consideration of citizens' requests to restore ownership rights to dwelling houses, their parts, flats, buildings used for economic and commercial purposes, as well as adoption of decisions on the restoration of ownership rights;
11) Execution of State guarantees for tenants moving out from dwelling houses or their parts and flats, which are returned to owners;
12) Preparation of documents for granting of citizenship;
13) Control of use and accuracy of the State language;
14) Management of archival documents assigned to municipalities in accordance with legal acts;
15) Participation in selecting draftees for military service;
16) Provision of statistical data;
17) Participation in preparing and implementing labor market policy measures and employment programs;
18) Participation in the organization of elections of the President of the Republic, elections to the Seimas and to municipal councils;
19) Participation in the preparation of plebiscites and referendums;
20) Participation in the carrying-out of population and dwelling census and other total census;
21) Entering of the data on the citizen's permanent place of residence in the passport of the citizen of the Republic of Lithuania and documents related to accounting of the data on permanent places of residence;
22) Other functions delegated by the law.

Article 9. Contractual Functions of Municipalities

1. Municipalities may exercise other State functions (public administration and public service rendering), which are not provided for in this Law, under contracts concluded with State institutions or agencies. A municipality may conclude such contracts only in the event that the municipal council gives its consent. Contracts shall be concluded and executed in compliance with the provisions of the Civil Code and other laws. Usually, contractual functions shall be short-term or seasonal.
2. For general purposes, a municipality may conclude joint activity contracts or public procurement contracts with State institutions and (or) other municipalities.

ANNEX II. FUNCTIONS OF THE COUNTY GOVERNORS IN THE REPUBLIC OF LITHUANIA, AS DEFINED IN THE COUNTY GOVERNANCE LAW OF 1994, WITH INCORPORATED AMENDMENTS ENACTED BY JANUARY 2001.[44]

Functions in the area of education, culture and social issues:

1) Observing the order established by law, to establish, reorganize and liquidate state educational institutions, except high schools, institutions and services of culture, physical culture and sports, social support and care, institutions of special social services.
2) To be in charge of functioning and maintenance of state institutions enumerated in paragraph 1.
3) To supervise the implementation of the state policy in the fields of education, culture and social affairs.
4) To prepare, coordinate and implement social programs and projects of the county.
5) To control the provision of social services in the social service institutions belonging to the county.
6) In conjunction with the territorial labor exchanges, to solve problems of residents' employment.

Functions in the area of health care and pharmaceutical activity:

1) To organize the implementation in the county of the state health care strategies and reforms approved by the Government.
2) To analyze the status of county residents' health changes in health condition, factors predetermining such changes, and to submit proposals coordinated with the respective municipalities to the Government and the Ministry of Health Care on the protection and strengthening of county residents' health.
3) In conjunction with the Ministry of Health Care, to establish, reorganize and liquidate county hospitals and specialized institutions of secondary health care included into the list approved by the Ministry of Health Care.
4) To organize the implementation in the region of public obligatory health care programs, drafting and implementation of programs of regional public health development, prophylactics of non infectious diseases and injuries.
5) To cooperate with the municipalities of the county in the formation of municipal community health councils and organizing their activities.

[44] The text is translated by Algirdas Petkevicius.

6) In accordance with respective law, to submit proposals to the Government to declare the county territory or its part an area of danger or harm to public health.
7) To carry out other functions foreseen by law in the field of health care.

Functions in the area of spatial planning and the protection of monuments:

1) To organize the preparation of county level spatial planning documents, to participate in their coordination.
2) To collect and administer the spatial planning data bank and the spatial planning data register, to provide information for other data banks.
3) To provide information, conclusions and proposals for drafting general and detailed spatial plans of the Republic of Lithuania.
4) In accordance with the law, to prepare conditions for county and municipal spatial planning documents.
5) In accordance with the established order, to supervise municipal spatial planning, preparation of projects for constructions, construction work, exploitation, destruction and recognition of constructions suitable for exploitation, to issue permits for construction, reconstruction, renovation or destruction of constructions of high importance approved by the institution authorized by the Government.[45]
6) In accordance with the established order, to supervise spatial planning.
7) To coordinate activities of municipal and state institutions in carrying out geodesic, topographic, cartographic and geo-informational work, to carry our the state supervision of this work in accordance with the established order.
8) To protect cultural heritage and monuments, to administer the respective data, to supervise the protection of monuments.
9) To carry out the functions of a client of objects of construction that belong to the county.

Functions in the area of land use and agriculture:

1) To administer the fund of free state land, except the land transferred to the institutions of local self-government to administer.
2) To implement the land reform.
3) In accordance with the law, to establish land servitudes and to carry out the state regulation of land use and the state control of land use.
4) To coordinate issues of agriculture, to distribute the quotas of the state purchase of agricultural goods, to implement rural development programs supported by state and SAPARD funds.
5) To control the use of measures for protection of plants.
6) To supervise melioration and hydro technical equipment, to organize the exploitation of melioration and hydro technical equipment belonging to the state.
7) To supervise the implementation of the Agricultural Company Law.
8) To sell or to transfer to the private property the state land, except lots of land attached to objects of real estate to be privatized, to represent the state in transferring private land to the state property or to the state, in accordance with the law or the testament.
9) To decide on the take over of land for public needs and on the change in the designation of the use of the land designated for special purposes.

[45] This paragraph shall enter into force on 1/08/2001 while the rest of the functions reflect the situation as it stood in May 2001.

Functions in the area of the exploitation of environmental resources and issues of environmental protection:

1) To organize activities in the protected territories belonging to the county, to participate in the administration of other protected territories, except reservations.
2) Within the established competencies, to submit proposals on the establishment of limits for the use of environmental resources.
3) To prepare state programs of the county in the field of environmental protection, as well as investment projects, to organize and coordinate their implementation.
4) Within the established competencies, to organize the management of water reservoirs, areas of coastal protection, and areas of protection of water reservoirs.
5) Within the established competencies, to control the condition, use, restoration and protection of public forests.
6) To organize ecological education.

Functions in other areas:

Without exceeding the established competencies:
1) To investigate applications of natural and legal persons and to adopt decisions. Decisions of the county governor are subject to appeal in accordance with the law.
2) To analyze social, economic and ecological conditions of the county, changes in these conditions, and provides respective information for residents.
3) To register the statutes of societal organizations whose activities encompass the territory of more than one municipality and whose headquarters are in the county center or in any other town or rural locality of the county.
4) To control the implementation of safe traffic programs of the state in the whole territory of the county.
5) To register tractors, road construction machines, tractor-trailers, self-moving vehicles.
6) To organize the liquidation of consequences of natural calamities, accidents, as well as search and rescue works.
7) To establish, reorganize, liquidate state enterprises, to administer shares of state enterprises entrusted to the county governor.
8) In accordance with the order established by the institution authorized by the Government, to represent the state in joint stock companies and closed joint stock companies, in which the manager of state shares is the Property Bank or another state institution.
9) To nominate and submit to the Government the candidates of the County Administrative Dispute Investigation Commission, as well as to nominate the chairman.
10) In accordance with the Regional Development Law, to implement the functions of the regional development institution.

ANNEX III. INVESTMENT INVENTORY

Important notice – a lot of public investment figures are provided in the local currency. The current exchange rate is 1 EUR = 3.45 Lithuanian Litas. This EUR – Litas exchange rate is fixed (pegged) and maintained by the Bank of Lithuania.

1. STATE BUDGET / STATE INVESTMENT PROGRAM

The Lithuanian state budget is currently based on a multi-annual planning approach and is compiled for a period of three years. The budget consists of two major parts: general programs and special programs. The major difference between them is that in general programs the unused funds must be returned to the budget and in the special programs, they are transferred to next year's budget automatically.[46] Although the EU structural funds and other international (non-returnable) aid are pointed out as a separate type of the budgetary program, in fact, it refers to the 'special programs' too, as much as the transfer of funds is concerned.

Another sub-division of the state budget is focused on the type of expenditures, and in this respect, all expenditures are divided into the major categories - 'ordinary expenditures', 'extraordinary expenditures' and 'remuneration expenditures'. 'Ordinary expenditures' refer to all expenditures that are not 'capital expenditures'. 'Extraordinary expenditures' are capital expenditures, including certain types of purchases of furniture and reconstruction works for a public organization itself and, most importantly, all investment in infrastructure. 'Remuneration expenditures' are a fraction of 'ordinary expenditures' earmarked for salaries of officials.

All 'extraordinary expenditures' of the state budget and some 'extraordinary expenditures' of the municipal budgets must be included in the State Investment Program, which is compiled and submitted to the Parliament along with the draft state budget. Extraordinary (or capital) expenditures are therefore included both in the State Investment Program and in other respective programs of the state budget. They are subject to (at least theoretically) double monitoring arrangements, since respective units of the Ministry of Finance monitor both the State Investment Program and other programs. However, figures of allocations in the State Investment Program and in other programs of the budget must correspond each other – consistency is ensured by both the managers of allocations and the Ministry of Finance as a monitoring institution.

The State Investment Program is subject to a specific procedure described in the Cabinet resolution No. 478 of April 26, 2001 "On the Approval of the Order of Planning, Concretizing, Using, Accounting and Controlling State Investment Earmarked for Capital Investment". The procedure allows full compliance with the rules of monitoring and control of the EU structural funds' allocations. It is also indicated that the Ministry of Finance and the Ministry of Economy shall prepare a general report on the implementation of the program after the end of the budgetary year, by May 1 of the following year

1.1. State Investment Program

The State Investment Program is a governmental program, which includes all investment expenditure of the central government. The detailed procedure of the preparation of the program is presented in Table 6, which illustrates the practical sequence of the process in 2001. This procedure can be generalized as follows:

Stage 1. The Cabinet's strategic planning committee identifies strategic spending priorities.

[46] Article 28, Cabinet Resolution No. 543, 14 May 2001 "On the Approval of the Order of the Composition of the State Budget and the Municipal Budgets of the Republic of Lithuania".

Stage 2. The Ministry of Finance and other institutions compile macro-economic forecasts and preliminary requests for allocations, including capital investment allocations.
Stage 3. The Cabinet's strategic planning committee identifies maximum allocations and gives the criteria for establishing the eligibility for maximum allocations.
Stage 4. The managers of allocations, after consulting the Cabinet office and the Prime Minister's office, together with the Ministry of Finance, prepare requests of allocations and the documents which ground these requests – strategic activity plans, etc.
Stage 5. The Ministry of Finance, together with institutions concerned, prepares the draft budget, including the draft state investment program, and submits them to the strategic planning committee, to the Cabinet, and then – to the parliament.

The priority for the State Investment Program in 2002-2004 was given to the projects which:

- are co-financed by the EU and other international financial institutions;
- are compatible with the aspiration to join the NATO (for defense projects);
- are related to objects which need urgent reconstruction and the use of which cannot be stopped;
- are related to specific decrees of the Parliament or the Cabinet;
- are related to government legal obligations in the legal acts;
- are already implemented and must be completed;
- shall be completed in the respective budgetary year.

Capital investment allocations must be used by the managers (spending agencies) without exceeding the indicated amounts. The data on the use of these funds is to be submitted to the Ministry of Finance bi-annually.

It is necessary to indicate that borrowed funds earmarked for capital investment cannot be used freely. They are fixed to concrete projects at the time of borrowing and must be used accordingly. Thus in 2002, the amounts which are relatively free to distribute make up 683,855 thousand Lithuanian Litas (out of total 1,156,926 thousand).

The approximate distribution of funds by the sector of concentration in 2002 shall include:

70,296,000 Lithuanian Litas	– to co-fund Phare projects.
31,626,000 Lithuanian Litas	– to co-fund ISPA environmental projects.
181,090,000 Lithuanian Litas	– to co-fund ISPA transport projects.
279,285,000 Lithuanian Litas	– to fund defense projects.
69,845,000 Lithuanian Litas	– to fund measures of agriculture.
80,257,000 Lithuanian Litas	– for education and improvement of conditions of education.
63,738,000 Lithuanian Litas	– for health care.
16,434,000 Lithuanian Litas	– for social care.
21,772,000 Lithuanian Litas	– for culture
23,426,000 Lithuanian Litas	– for civil defense.
318,319,000 Lithuanian Litas	– for transportation (including 159,267,000 Litas from state budget, 41,882,000 – from state loans, 117,170,000 – from loans with the state guarantee).

International institutions shall contribute an additional 133,082,000 Litas, of which

- 18,523,000 – from PHARE,
- 114,559,000 – from ISPA,
- 68,185,000 – from own funds of spending agencies.
- 94,769,000 Lithuanian Litas – for environment (including 338,294,000 from the state budget, 32,425,000 – from state loans, 23,300,000 – loans with the state guarantee).

International institutions shall contribute additional 113,600,000 Litas, of which

- 10,200,000- from PHARE,
- 87,072,000 – from ISPA,
- 13,390,000 – from other grants,
- 11,564,000 – from own funds of spending agencies.

The regional location of capital investment in 2002 is presented in Table 2. As seen from the table, the most industrialized counties – Vilnius, Kaunas and Klaipeda – shall get a comparatively large share of funds; i.e., 2-4 times larger than other any other county. It should be noticed that these figures in Table 2 include the distribution of major investment by location, not by manager of funds. In cases when a project shall be implemented in two counties, the total foreseen investment is divided by 2 and ascribed to the two respective counties. However, when the project is national in scale and/or designation, it is indicated in a separate column and no regional 'affiliation' is attached.

The management and monitoring of state capital investment is based on bi-annual reporting, as already indicated above, and do not have to consult any specific collective bodies. The work is done by the respective managers and by the Ministry of Finance. The annual reports shall then be submitted by the Ministry of Finance to the Cabinet's strategic planning committee and, before being submitted, may be reviewed by the Cabinet office and/or the Prime Minister's office.

1.2 General Programs

Although general programs are very many, only one of them (in fact, a part of the program) is presented here, due to its importance to regional development and development in general. It should be noticed that the EU structural aid and other international aid is expected to be channeled via special programs outlined below.

Employment Creation Program

In 2001, the Government of Lithuania approved the National Employment Creation Program for 2001-2004. The program emphasizes the promotion of small and medium-sized business. Main directions of the program are the promotion of entrepreneurship, the improvement of support for employment, adaptation to new trends in the labor market, equal opportunities in the labor market.

Local Employment Initiatives Scheme

In order to facilitate its implementation, the Ministry of Social Protection and Labor established a local employment initiatives scheme. In 2001, USD 301,000 was earmarked for this grant scheme in the state budget. It is expected that a larger amount of money will be allocated for this grant scheme in 2002.

The grant scheme finances the implementation of one-year local employment projects. There are five main objectives of the grant scheme:

- Create new working places;
- Create more favorable conditions for economic activities;
- Reduce the vulnerability of different locations to structural adjustments of the economy and increase their development potential;
- Provide assistance to the development of local community.

Every project application should be compatible with one or more objectives of the grant scheme. The main objective of the grant scheme is the establishment of new working places.

Only local authorities with high levels of unemployment are eligible under the grant scheme. These areas are determined by the Employment Council under the Ministry of Social Protection and Labor In 2001, ten local authorities (namely, Amen, Siauliai, facial, Druskininkai, Jurbarkas, Pasvalys, Jonava, Sirvintos, Joniskis, Pakruojis) out of sixty local authorities were selected to participate in the grant scheme.

The implementation of this scheme is governed by an Implementation Document approved by the Order approved of the Minister of Social Security and Labor. The project selection, financing and control are the responsibility of the National Labor Exchange and territorial labor exchanges located in the local authorities participating in the grant scheme. In addition, special advisory bodies were established to support the management of the grant scheme on a local and national level.

Local project management commissions under the territorial labor exchanges check the eligibility of project proposals, evaluate project proposals according to the project evaluation criteria and monitor the implementation of projects. Equal number of employers, employees and government (tripartite cooperation) are represented in the local commissions.

A Project Monitoring Committee under the National Labor Exchange carries out a second evaluation of projects submitted by the local commissions, approves projects, discusses and approves implementation reports submitted by the National Labor Exchange. The Committee is headed by the Deputy Head of the National Labor Exchange. The National Labor Exchange, the Ministry of Social Security and Labor, the Ministry of Economy, the Small and Medium Enterprise Development Agency, the Lithuanian Business Employers Confederation and the Confederation of Trade Unions and other institutions are represented on the Committee.

Both natural (entitled to be engaged in economic activities in Lithuania) and legal entities (business enterprises and other organizations with the exception of all public administration institutions), which are located in the participating local authorities, are entitled to present their project applications. However, in practice only legal entities are eligible. In addition, project applicants should be capable of implementing the proposed projects.

According to the Order, a grant may not exceed 65 percent of the total project costs. The remaining 35 percent of the total project cost should be financed from other sources of project applicants and their partners. Although there are no minimum and maximum amounts of financing under this grant scheme, a grant may not exceed 40 minimum monthly wages for the establishment of one working place. In practice, project applicants are contributing up to 60 percent of own revenues to the project implementation.

In 2001, a total of 86 projects were submitted to the territorial labor exchanges participating in the grant scheme. During the evaluation of project applications priority was given to local authorities with higher levels of unemployment. The Project Monitoring Committee under the National Labor Exchange selected fifteen projects for financing: four in Akmene, two in Pasvalys, Druskininkai and Sakiai, one in Jonava, Siauliai, Jurbarkas, Pakruojis and Sirvintos local authorities.

It is foreseen that 146 working places will created after the implementation of these projects. Grant recipients are required to keep working places, whose establishment was assisted by the grant scheme, for at least three years as well as to make them available to the unemployed registered in the territorial labor exchanges. Also, project applicants in their applications should demonstrate favorable social impact to local communities.

The territorial labor exchanges sign contracts with the successful project applicants. Payments are made to grant beneficiaries as follows: an advance payment of 30 percent is made after the signature of the contract, an interim payment of 50 percent - after completing 50 percent of the work program and a final payment – after the project completion. Every quarter, grant recipients should submit implementation reports to the appropriate territorial labor exchange describing both financial and technical progress.

1.3. Special Programs

The special programs were introduced in 2001. They are regulated by the Cabinet Resolution No. 543, May 14, 2001 "On the Approval of the Order of the Composition of the State Budget and the Municipal Budgets of the Republic of Lithuania". Most of the governmental foundations (off-budget funds) were restructured into such special programs. Some of these programs are outlined below.

The funds in the special programs are divided into two categories:

- Funds received by managers from duties, tariffs, services. These funds, except when they are regulated by the Tariff Act (in which case, they are transferred to the budget and are not ascribed to a concrete manager), are returned to the institution, which earned such funds by means of a special program. The budget of such programs is prepared in accordance with the general order, which applies to all budgetary programs.
- Funds administered by the managers (which are not earned by them). Such funds are earmarked on the basis of special programs submitted by the managers.

Most of the funds that are of importance to development are of the second category.

Business support programs

In the Ministry of Economy, there are three special business support programs allocating grants to business subjects: a program for the implementation of the export promotion and facilitation strategy (the Export Program), a program for the implementation of the SME development and promotion strategy (the SME Program) and a program for the industrial competitiveness promotion (the Industry Program). The status of a special budgetary program allows the Ministry of Economy (the manager of budgetary appropriations) to move unspent money forward to the following financial year

In 2001, about USD 6.7 million of budgetary revenues were earmarked for three special programs. In addition, the Ministry of Economy allocated USD 11.28 million from its own administrative revenues for the implementation of these programs, increasing their total volume to USD 17.98 million. The programs include both operating and capital expenditures. However, the latter are very small.

Although the budgetary programs are three-year programs, second-year and third-year allocations are indicative. In order to receive a similar amount of funds in the two following years, every manager of budgetary appropriations has an incentive to contract and disburse all funds by the end of the financial year.

In November 2001, the Ministry of Economy managed to contract about 88.6 percent of the SME Program and 100 percent of the Industry Program. However, it is unlikely that the whole allocation will be spent by the end of 2001. This can be explained by two main reasons: a shortage of eligible project applications and a short period of project implementation.

The table below presents financial volumes of all special programs for 2001 and 2002 (provisional). In the programs, emphasis is placed on quality and export promotion.

Table I. Volume of Business Support Programs, USD Million

Program	2001	2001*	2002 (provisional)
Export	1.86	12.88	0.76
SME	1.73	1.99	1.57
Industry	3.11	3.11	3.10
Total	6.7	17.98	5.43

* Including own administrative revenues of the Ministry of Economy (USD 11.28 million)

CASE STUDY: TYPES OF EXPENDITURE OF THE 2001 SME PROGRAM

> Preparation of legal and other normative acts, programs and statistical surveys about business conditions; Founding of the closed joint stock company "Investment and Business Guarantees"; Participation fee for the EU SME development program and other co-financing expenditure; Preparation of regional and special programs and their implementation; Assistance for business information, training and advisory services; Technical assistance; Development of business incubators (reimbursement of establishment and operation costs); Reimbursement of interest on loans to SMEs (the closed joint stock insurance company "*Lietuvos eksporto ir importo draudimas*").

The main institution responsible for the management of these programs is the Business Development Council. The Council is a collegiate body approved by a decree of the Minister for Economy. According to its statute, the Council allocates financial support from the special programs to business subjects. In addition, the Council acts as the Ministry of Economy's advisory body in the area of enterprise policy. It analyses problems of industrial, business and export development and should be consulted on the priorities and instruments of enterprise policy, and should monitor and evaluate the implementation of strategies.

The Council is chaired by the Minister for Economy. The Ministry of Economy provides a secretariat to the Council. The following institutions are represented in the Council:

- The Ministry of Finance,
- The Ministry of Economy,
- The Ministry of Foreign Affairs,
- The Ministry of Agriculture,
- The Ministry of Interior,
- The Ministry of Culture,
- The Ministry of Transport,
- The Lithuanian Economic Development Agency,
- The Lithuanian Confederation of Industrialists,
- The Association of the Chambers of Trade, Industry and Craft,
- The Lithuanian Association of Banks,
- The Lithuanian Confederation of Business Employers,
- The Lithuanian Association of Municipalities,
- The Interministerial Council on SMEs (an expert on SMEs),
- The Lithuanian Council of Science (an expert on innovation).

The Council meets at least once every quarter. By November 1, 2001, the Council met four times: in March, in May, in July and in October. According to the statute, the chairman calls meetings and presents the agenda to the members of the Council at least five days in advance. All applicants are automatically represented in the meetings when their application is discussed, but the Council may invite other participants.

Decisions are made by majority vote, but at least eight members of the Council in total and four members of the public administration institutions should be represented. During the meetings of the Council, priority is given to the allocation of grants from the special business support programs.

The Council is assisted by respective departments and divisions of the Ministry of Economy as well as three permanent committees. Departments and divisions of the Ministry of Economy receive and assess project applications, make recommendations to the Council, organize and control the execution of decisions adopted by the Council.

There are three permanent committees (one committee for each special program), which discuss recommendations submitted by the Ministry of Economy in their area of expertise. The implementation of the SME program is supervised by the SME and tourism permanent committee.

Although there are three executive agencies under the authority of the Ministry of Economy (the SME Development Agency, the Lithuanian Development Agency and the Innovation Center), the delivery mechanisms are underdeveloped in the area of business support. Therefore, the main instrument of financial support is grants to business subjects.

Grants from the business support programs are allocated to business subjects according to guideline documents for 12 different types of economic activities. In the beginning of every financial year, the Ministry of Economy prepares an indicative breakdown of financial volumes according to different types of economic activities for each business support program. These guideline documents concern:

- Participation in, and organization of, international and national exhibitions (see case study below);
- Certification of quality management systems, environmental management systems and goods of Lithuanian-origin;
- Partial reimbursement of interest on loans;
- Publications promoting information and Lithuania's image abroad;
- Insurance against non-market and political risks;
- Various SME development projects, etc.

Project applications should be prepared according to the requirements of these guideline documents. Also, grant recipients should comply with a special methodology for the use of grants adopted by the Business Development Council.

CASE STUDY: PARTICIPATION IN, AND ORGANIZATION OF, BUSINESS EXHIBITIONS

This type of activity is financed from the Export Program according to the guideline document "Participation of Business Subjects in International And National Exhibits" approved by the Minister for Economy in June 2000. According to the guidance document, every financial year the Ministry of Economy should receive applications from business subjects by October 1. In addition, business subjects should revise their applications two months before the launch of business exhibitions. In 2001, about USD 1.25 million was allocated for the participation in, and organization of, business exhibitions, about 50 percent more than in 2000. Applications in this type of activity are co-financed by the Ministry of Economy at the rate of 50 percent (for the participation in, and organization of, international exhibitions) or 30 percent (for the participation in, or organization of, national exhibitions). The remaining percentage of expenditures should be covered by the applicants. In 2000, the Business Development Council accepted more than 40 applications. In the first quarter of 2001, the Ministry of Economy received 23 applications for the participation in, and organization of, business exhibitions. The Business Development Council accepted 18 applications, rejected 2 applications, while 3 applicants withdrew their applications. Increasing amount of applications illustrates growing demand for business support in this type of economic activity.

Roads Fund / Special Program of Roads' Maintenance and Development

Indeed, the Special Program of Roads' Maintenance and Development is the only program, which specifically deals with the municipal needs. All other governmental special programs which deal with issues of development, are targeted at sector development and rarely have any regional dimension, even though sometimes regional development plans or regional needs may be taken into consideration when approving business development projects, as outlined above, or other types of projects.

The Roads Fund was set up by the Roads Fund Law adopted by the Lithuanian Parliament in January 1995, and which was abrogated on January 1, 2002. As defined in this Act, the objectives of the Roads Fund have been the development, modernization and functioning of the network of automobile roads. The manager of the fund has been the Automobile Roads' Board under the Lithuanian Ministry of Transportation. After reorganizing the Fund into a special program, the order of the use of allocations and the managing organization did not change. The focus of allocations of the Fund is roughly distributed as follows:

- 75 percent - for the development of roads' infrastructure of national importance.
- 20 percent - for construction, reparation and maintenance of local roads, as well as roads in forests and national parks.
- Up to 5 percent - reserve of funds for other governmental needs in the field of roads' development (includes funds to ensure ferry connections between Neringa and Klaipeda).

Funds earmarked for construction, reparation and maintenance of local roads (20 percent of the total budget, as outlined above) are further distributed to:

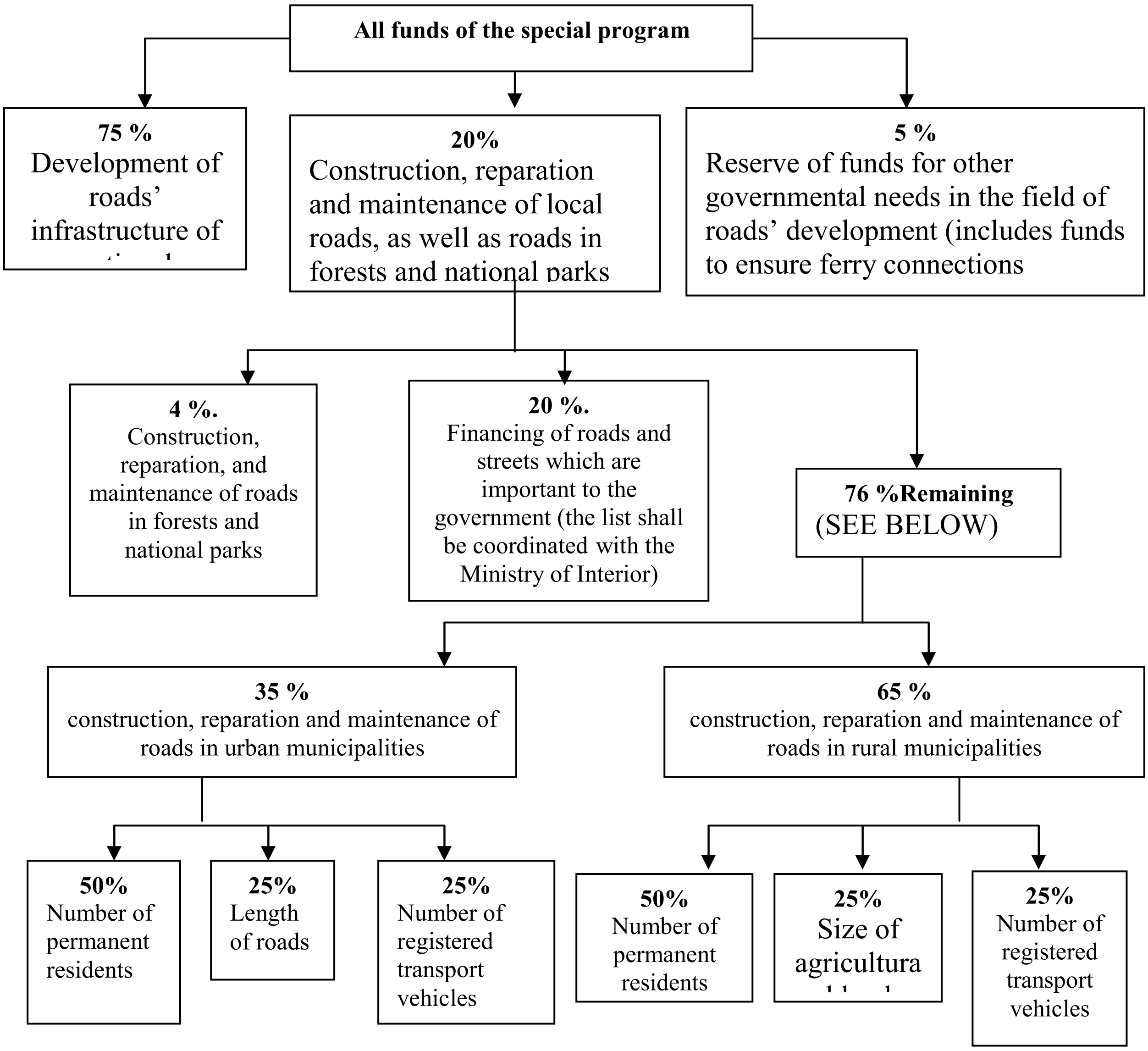
- 4 percent - for construction, reparation, and maintenance of roads in forests and national parks.
- 20 percent - for financing of roads and streets, which are important to the government (the list shall be coordinated with the Ministry of Interior).
- 76 percent - for other needs, which can be divided into 35 percent - for construction, reparation and maintenance of roads in urban municipalities, and 65 percent - for the same purposes in rural municipalities.

These 76 percent shall be distributed to the municipalities (whether urban or rural) according to the following criteria:

- 50 percent – based on the number of permanent residents.
- 25 percent – based on the length of roads (in rural municipalities – size of agricultural land).
- 25 percent – based on transport vehicles registered in the municipality.

The whole budget of the fund is thus illustrated in the Scheme below.

Scheme 1. Distribution of the Road Fund



The funds designated for municipalities are used on the basis of lists of objects submitted to the manager of the funds by the respective municipalities. It is expected that in 2002,, municipalities shall get from the special program approximately 97 million Lithuanian Litas. In addition, they will get 56 million Litas for roads and streets from the State Investment Program. The total budget of the special program in 2001 is outlined in Table 7.

1.4. Off-budget funds

By March 29, 2000, there were 26 different off-budgetary funds associated with the central government budget in Lithuania. These funds had different managing boards, different volumes and different orders for funds' allocation and administration. The amounts in all the funds totaled approximately ten percent of the national budget. Since the situation did not contribute to the effectiveness of the use of governmental funds, on March 29, 2000, the Lithuanian Cabinet adopted protocol No. 16, by which the off-budget funds were to be restructured. At the present time, the status of the reform is as indicated in the following table.

Table II. Status of Off-budget Fund Reform

I.FUNDS, THE STATUS OF WHICH DID NOT CHANGE. (Budgets of these funds are submitted to the Parliament along with the draft state budget. These funds are independent legal persons.)	1. The State Social Insurance Fund 2. The Mandatory Health Insurance Fund
II.FUNDS THAT BECAME INDEPENDENT PARTS OF THE BUDGET. (Budgets of these funds are submitted to the parliament along with the draft state budget.)	3. Privatization Fund 4. Savings' restoration account (a part of the Privatization Fund) 5. Fund for the Closure of the Atomic Power Station in Ignalina
III.FUNDS ABOLISHED AS INDEPENDENT FUNDS. (Budget of these funds is a part of the state budget. Expenditures of these funds are included and accounted for in the budgetary programs.)	6. Special Fund for Privatization of Flats 7. Fund to Comply with the Requests Related to Labor Relations of the Employees of Enterprises which are Bankrupt or under Bankruptcy 8. Lithuanian Education Fund 9. Agricultural Reform Fund 10. Road Traffic Security Fund 11. Residents' Deposits Compensation Fund 12. Vocational Training Fund 13. Fisheries Fund
IV.FUNDS RESTRUCTURED TO THE SPECIAL PROGRAMS OF THE BUDGET. (The status of special programs of the budget is applied to these funds.)	14. Fund to support the purchase or construction of dwelling houses or flats – special state program to finance purchase of dwelling houses and flats 15. Agricultural reform fund – special program of agricultural reform 16. State environmental protection fund – special program of environmental protection 17. State health fund – special program of strengthening and modernization of health care 18. Forestry fund – special program of financing of needs of forest economy 19. Export promotion fund – special program 'The implementation of export development and promotion strategy' 20. Roads fund – special program of roads' maintenance and development 21. Energy saving fund – special program 'the implementation of energy saving measures' 22. Rural development fund – special program to support rural development 23. Non-governmental institution 'Media and TV support fund' – without changes 24. SME development fund – special program 'the implementation of the SME development strategy' 25. Culture and sport support fund – without changes 26. Blockade fund

Issues related to the relevant funds in category IV are addressed in the chapter dealing with the state budget. Funds of category I, II or III are irrelevant to this inventory, since they do not have linkages with development. The exception is the Fund for the Closure of the Atomic Power Station in Ignalina, since it is focused on one particular region that may potentially become 'a depressed region' after the closure of the station.

Fund for the Closure of the Atomic Power Station in Ignalina

The fund was established in accordance with the Law on the Fund for the Closure of the Atomic Power Station in Ignalina. The annual budget of the fund shall be submitted to the Parliament along with the draft state budget. The budget for the year 2002 of the fund is presented below:

Table III. Budget for the Fund for the Closure of the Atomic Power Station, Ignalina (2002)

Item of Expenditures	Amount of Expenditures (Thousands of Lithuanian Litas)
I. Remainder of funds on January 1, 2002	134,951
II. Forecasted income of the fund in 2002	55,499
III. Expenditures:	
1. Remuneration of personnel in charge of closure	770
2. Social security payments	240
3. Implementation of the part of the land re-cultivation project in the territory of the station, geodesic measurements, legalization of their rent	3,000
4. Other expenditures	72
5. Unforeseen expenditures	820
6. Total expenditures	4,902
IV. Forecasted remainder of funds on January 11, 2003	185,548

The founder of the fund is the Lithuanian Government, which appoints the managing board via an authorized institution. The lucrative funds are administered by the Ministry of Finance. The managing board, which consists of seven members representing academic, governmental and self-government institutions, decide on which projects to be financed and on investment in the financial market. The sources of the fund's budget are a share of revenues of the atomic power station for sales of electricity, international contributions, interest and dividends for invested funds. The funds are released on the basis of the budget approved by the Parliament. They must be used for closure of the station, burial of nuclear fuel and, if necessary, compensation of damages caused by the nuclear fuel.

1.5. EU Structural Assistance Funds

The institutional responsibilities for the management of the EU structural assistance funds are indicated in several Cabinet resolutions (Resolution No. 649, May 31, 2001, 'On the Distribution of Responsibilities among Lithuanian Institutions for the Implementation of EU Structural Aid in Lithuania'; and Resolution No. 953, July 31, 2001, 'On the Order of Administration and Control of EU Assistance Funds').

Resolution No. 649 indicates that the Ministry of Finance is in charge of general coordination. The functions of the paying authority shall be distributed as follows:

- The Ministry of Finance – in charge of the European Regional Development Fund.
- The Ministry of Social Security and Labor – in charge of the European Social Fund.
- The Ministry of Agriculture – in charge of the Guidance section of the European Agricultural Guidance and Guarantee Fund.

The actual administration of the funds is entrusted by this decree to the Ministries of Economy, Social Security and Labor, Education, Transport, Environment, or Interior, depending on the project profile.

This resolution is, however, applicable to the funds that Lithuania shall receive after joining the EU only. Resolution No. 953 regulates institutional responsibility for the EU structural pre-accession initiatives: ISPA, SAPARD, and PHARE Economic and Social Cohesion, which are supposed to be prototypes of the EU structural funds and which are available already now. According to this resolution:

- The Ministry of Finance shall be in charge of overall coordination and monitoring;
- The Ministry of Agriculture – in charge of SAPARD program;
- The Ministries of Environment and Transport – in charge of relevant components of the ISPA program;
- The Ministry of Economy – in charge of business development component of the PHARE ESC;
- The Ministry of Education and the Ministry of Social Security and Labor – in charge of training/education components of PHARE ESC;
- The Ministry of Interior – in charge of regional policy and indigenous development.

In addition to these legal acts, relevant EU regulations and agreements between the EU and Lithuania apply, namely:

- The Law on Ratification of the SAPARD Program in Lithuania.
- The Operational Guidelines for PHARE 2000 ESC (formally approved by the Lithuanian Ministry of the Interior and the European Commission's delegation to Lithuania).
- The ISPA Guidelines.
- Other relevant documents.

PHARE 2000 Economic and Social Cohesion

The PHARE 2000 Economic and Social Cohesion initiative was offered by the European Union's Commission in early 1999. While a part of the regular PHARE program, the economic and social cohesion initiative is targeted at the improvement of development conditions in the selected Lithuanian regions.

The amount of funding available is EUR 14 million, which must be contracted by the end of 2002 and disbursed by the end of 2003. The funds are earmarked for measures in the field of business development, vocational training, small-scale infrastructure, business consultancy and other related fields. All measures are to be implemented in four counties only: Klaipeda, Taurage, Marijampole, and Utena. The Cabinet of Lithuania shall co-finance the measures. The ratio of EU to Lithuanian contributions shall be 75 percent to 25 percent respectively.

The project proposals for this initiative must come either from a subject of economy or service provider located in one of the four counties or by a subject of economy or service provider, whose project is designed for and shall be implemented in the indicated counties.

The money flows are managed jointly by several institutions: the Ministry of Interior, the Ministry of Finance, and the four county governors' administrations in the respective counties. In the Ministry of Finance, the key role in managing the funds shall be played by the National Fund Department of the Ministry of Finance and the Central Finance and Contracting Unit under the Ministry of Finance. In the Ministry of Interior, the funds shall be managed by the Regional Development Department and by contracted consultants or companies. In the respective county administrations, the funds shall be managed by the designated employees and, too, by the consultants or companies contracted by the Ministry of Interior.

The manager of the EU contribution is the Ministry of Finance and the Central Finance and Contracting Unit under the Ministry of Finance. The manager of the national contribution is the

Ministry of Interior. However, in order to avoid "double contracting", the system has been created under which the Ministry of Finance and the Ministry of Interior entrust the Central Finance and Contracting Unit under the Ministry of Finance to carry out functions of tendering and contracting. Thus, the Central Finance and Contracting Unit signs contracts with aid recipients and then requests the National Fund under the Ministry of Finance to transfer allocations directly to the recipients. However, prior to signing the contracts, the Central Finance and Contracting Unit under the Ministry of Finance must obtain endorsements from the designated official of the Ministry of Interior and the designated official of the European Commission's delegation.

The Central Finance and Contracting Unit does not, however, have sufficient capacities to deal with all issues. As a result, it may sub-contract some of its functions to the institutions pre-approved by the European Commission services. These institutions are the county administrations of the four counties – aid recipients.

Therefore, while the Central Finance and Contracting Unit is in charge of all major aspects of program management (tendering, contracting, monitoring), in reality the four county administrations are supposed to do most of this work, under the CFCU's responsibility. The Ministry of Interior is also supposed to be in charge of maintaining the overall basis of technical monitoring, to receive from the county governors periodical progress reports and the monitoring data, to set up and provide services for the joint monitoring bodies.

There are 2 joint monitoring bodies dealing specifically with program management: the Monitoring Sub-Committee for PHARE Economic and Social Cohesion initiative and the National Management Committee for PHARE Economic and Social Cohesion initiative. The first one consists of the representatives of the Ministry of Finance, European Commission and representatives of implementing agencies and is charged with the task of monitoring the progress and proposing amendments to the program. The second one consists of representatives of all the key ministries and implementing agencies concerned and is in charge of approving tender dossiers, terms of reference, monitoring and controlling activities of regional implementing agencies, establishing project selection committees.

Importantly, the PHARE 2000 Economic and Social Cohesion initiative is a part of the PHARE program and is, therefore, also subject to its management arrangements. This means that the Memorandum of Understanding on the Establishment of the National Fund applies to this initiative. According to the memorandum, the Deputy Minister of Finance is the National Authorizing Officer of all PHARE allocations and he/she is responsible to the European Commission for the correct and efficient use of allocations. As a result, all PHARE 2000 Economic and Social Cohesion funds are also Deputy Minister's responsibility, although in reality this responsibility is reduced to a minimum. The Deputy Minister is expected to trust the Central Finance and Contracting Unit under the Ministry of Finance, although the ministries own personnel may also scrutinize submitted documents.

The allocations make up EUR 6 million for Klaipeda and Taurage counties and EUR 4 million for Marijampole and Utena counties respectively. The national share must be added accordingly and makes up _ of the total amount. Private contribution of up to 20 percent may be required, but is not yet firmly fixed. In most cases, in-kind contribution shall be accepted.

In Klaipeda and Taurage counties, the allocations are focused on: [47][48]

- Development of entrepreneurs and support to new enterprises EUR 1,125,000;
- Support to competitiveness of enterprises – EUR 1,500,000;

[47] Please note that the distribution of funds may change. This will not, however, affect the total amounts available for each county.

[48] Both development of favorable climate for investment and innovations, development of entrepreneurs, support to competitiveness of enterprises, innovations etc. are focused on private (profit generating) and non-for profit projects that may achieve the stated objectives (promotion of entrepreneurship, investment, etc). There is little precision in defining the eligibility – thus projects can be wide in scope. It is important that they contribute to the stated objectives (which will be assessed by the Selection Committees) and comply with a certain set of rules.

- Business and investment related infrastructure – EUR 1,500,000;
- Vocational training – EUR 800,000;
- Distance learning system – EUR 900,000;
- Establishment of women's employment centers – EUR 175,000.

In Marijampole County, the allocations are focused on:
- Development of favorable climate for investment and innovations – EUR 2,450,000;
- Vocational training – EUR 1,050,000;
- Strengthening administrative capacities – EUR 200,000;
- Training initiatives – EUR 300,000.

In Utena County, the allocations are focused on:
- Business consultancy and the development of favorable investment climate – EUR 1,340,000;
- Innovations – EUR 760,000;
- Vocational training – EUR 1,200,000;
- Strengthening administrative capacities – EUR 200,000;
- Training initiatives – EUR 500,000.

A national share of _ must be added to each indicated amount, which shall be allocated from the state budget.

In most cases, measures shall be focused on "soft" measures, such as business and investment consultancy, consultancy and provision of technical documentation for introduction of ISO 7000 standards, vocational training. Some limited infrastructure shall also be funded, especially in the framework of establishing distance learning systems, introduction of ISO standards.

PHARE 2001 Economic and Social Cohesion

PHARE 2001 Economic and social cohesion initiative is the continuation of the analogous initiative within PHARE 2000. It shall most likely commence in 2002 and terminate by the beginning of 2005. However, significant delays may be expected (please note – PHARE 2000 Economic and Social Cohesion initiative shall commence in the beginning of 2002 only, with at least 1-1.5 years of delay).

The total expected PHARE contribution EUR 15.58 million, (the expected national contribution, EUR 4.32 million).

This initiative represents a shift in the EU policies from regional development support to support of the country's structural adjustment without an apparent regional focus. However, due to the importance of Utena County in EU policies (because Ignalina nuclear power plant, to be closed according to the agreement between Lithuania and the EU, is located there), two measures are to be implemented in this county:
- Framework for economic restructuring in Visaginas, Ignalina and Zarasai municipalities;
- Tourism information and infrastructure in Utena region.

The managerial structures are not yet decided. However, it is most likely that the role of the Central Finance & Contracting unit under the Ministry of Finance and of the National Fund Department in the Ministry of Finance shall be the same as in PHARE 2000 Economic and social cohesion initiative. The major manager of the funds will probably be the Ministry of Finance itself (in PHARE 2000 ESC, it is the Ministry of Interior and the four county governments). However, since the administrative capacities of this ministry are weak, other solutions may also be chosen.

The breakdown of PHARE 2001 allocations is presented in the Table 1. All allocations in PHARE 2001 are targeted nationally, although regions that were selected for PHARE 2000 support are supposed to get further investment in infrastructure (which were not available in PHARE 2000). Clear targets of the program are: innovations, environmental infrastructure and promotion of economic activity in the region of Utena (because of expected closure of the Visaginas Atomic Power Plant – a generator of major income in the region).

ISPA

ISPA (Instrument of Special Pre-Accession) is a EU structural support initiative for the year 2000-2006, targeted at environment and transport infrastructure. In the field of environment, preference is given to water protection, waste management, air quality, and drinking water, particularly in the light of the adoption of the EU rules (achieving EU standards) in these fields. In the field of transportation, the funds are focused on highways, railways, and airports.

The allocations for 2000-2006 make up EUR 50 million p.a., although in the reports, figures tend to vary between 50 and 65 million. A national share of at least ¼ (in exceptional cases – 1/5) must be added. In most (almost all) cases, however, the national share in the year 2000-2006 shall amount to ½ of the allocations.

The environmental and transport components are managed separately. Financial obligations of the EU and the Lithuanian government are established in the annual financing memoranda. Funds are received by the National Fund in the Ministry of Finance and transferred to implementing agencies. Implementing agencies are in charge of managing the funds in accordance with EU rules established in the 'SCR Manual for PHARE, ISPA and SAPARD Funds'.

The ISPA Monitoring Committee is established and consists of representatives of the Ministry of Finance, European Commission, Implementing Agencies and international financial institutions. The committee is to meet twice a year to assess and monitor the progress of program implementation, to suggest reallocation of measures, if necessary.

ISPA allocations shall be focused on transport infrastructure of national significance (railways, roads, airports), as well as on selected water purification facilities (Vilnius municipality got preference for the first year of ISPA funding).

SAPARD

The SAPARD initiative is a EU structural support instrument specifically targeted at agriculture and rural development, including rural infrastructure. There are eight areas of action eligible for SAPARD funding, namely:

- Agricultural production;
- Processing and marketing of agricultural goods;
- Diversification of economic activities in rural areas;
- Rural Infrastructure;
- Forestry;
- Environmentally friendly agricultural methods;
- Vocational training;
- Technical assistance, information and publicity campaigns.

The Rural Development Plan for SAPARD enumerates concrete figures of allocations for each projected measure, including the national and EU share.

In the SAPARD program, the National Fund Department and the National Authorizing officer (Deputy Minister of Finance) play the same role as in PHARE and ISPA. However, contrary to stratified management arrangements in those two initiatives, in case of SAPARD, the only implementing agency is the National Paying Agency under the Ministry of Agriculture. Having established quite a strong internal structure, the Agency keeps control over all aspects of funds management, including tendering, contracting, financial control, monitoring, and audit. There are specific units within the Agency that deal with specific issues. Primary processing of applications shall take place at the local level and will be done by the Rural Development Units (located in each municipality and subordinated to County Governors). However, after the initial processing, the selection shall be made and funding arranged by the National Paying Agency.

PHARE SPF

In 1999, the European Parliament created a special budget line for 'Special Action in Favor of the Baltic Region'. Within the Action, a PHARE Small Projects Fund (SPF) has been created, with an aim to support small-scale co-operation projects in the Baltic Sea Region.

The SPF supports the key objectives of the Special Action for the Baltic Sea Region Program, namely to help the border regions to overcome specific development problems resulting from their relative isolation in the framework of national economics. The SPF also supports the establishment and development of cooperative networks within the Baltic Sea Region and the creation of linkages between these networks and wider European Union networks.

More specifically, the SPF aims:

- To support the further development of the economic potential of the regions bordering the Baltic Sea by strengthening existing structures;
- To reduce the peripheral character of these areas, thereby improving the quality of life and creating a co-operative networking in that region;
- To contribute to the development and strengthening of an effective implementation structure for the program.

The SPF is implemented by announcing Calls for Proposals every year according to the Guidelines for Applicants. In 1999, the financial volume of the SPF was about EUR 0.95 million. The indicative amount available under the 2000 Call for Proposals is about EUR 0.93 million.

The program can allocate grants for the individual projects between EUR 10,000 (the minimum amount) and EUR 300,000 (the maximum amount). However, the size of a grant may not exceed 80 percent of the total eligible project costs. The balance must be financed from the applicant's or partners' own resource. The applicant and/or partners must finance at least 20 percent of the total project cost. Co-financing can be provided in cash and/or in-kind.

There are three sets of eligibility criteria. These concern organizations which may request a grant, projects for which a grant may be awarded as well as types of cost which may be taken into account for the amount of a grant.

Applicants must act in consortium with partner organizations. They should have at least two partners. Applicants must have a minimum of one additional eligible partner from a country of the Baltic Sea Region (Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland or Sweden) other than the applicant's country. Projects meeting this criterion may further involve additional partners from bordering regions of Russia (Kaliningrad) and/or Belarus (Minsk, Grodno, Brest and Vitebsk provinces) and/or Norway, in so far as funding for the Russian/Byelorussian/Norwegian partner can be provided outside PHARE, by the TACIS or Interreg program or other source.

Twenty-one projects were selected and approved from the 1999 SPF. Eight projects originated from the Klaipeda County, four from the Kaunas County, three from the Marijampole county, two from the Siauliai county, one from the Utena, Taurage, Alytus counties. In addition, one national project was approved. The duration of a project normally does not exceed twelve months. However, the duration may be up to eighteen months, if a full justification is given.

The following sectors are eligible under the PHARE SPF:

- Economic Development (promotion of business co-operation; enterprise development; marketing initiatives; financial co-operation and co-operation between institutions representing the business sector; aid to investment and provision of supporting services and facilities, in particular for technology transfer and for marketing for small and medium-sized enterprises; markets; exhibitions and advertising events; the creation of cross-border co-operation structures and partnerships among supporting organizations);
- Local Democracy (training courses and information dissemination, exchange visits, project preparation and procedural matters, helping to create and intensify skill of local and regional public administration structures and socio-economic partners, e.g., chambers of commerce, trade associations, NGOs, etc.);
- Training and Employment (training initiatives, exchange of know-how and experience in education at various levels, local employment and education);
- Cultural exchanges (meetings and exchanges among youth; artistic and supporting activities; folk events and similar actions with the emphasis on the establishment of traditions and long-term co-operation);
- Planning and development studies (joint planning in a border region, framing of joint research programs, drawing up joint strategies for regional development in a border area, feasibility studies, etc.);
- Environment (drafting of studies, assessment of problems, environmental training, actions aimed at increasing public environmental awareness and so forth. Small-scale investment projects having a direct and clear impact on the cleaning of the Baltic Sea environment can also be included);
- Tourism (studies, planning, institutional strengthening measures, establishment of tourism information centers, bicycle routs, specific training, etc.);
- Health (co-operation in health, particularly the sharing of resources and facilities on a cross-border basis);
- Social affairs (support for marginalized groups of the populations, such as members of minority group, handicapped, elderly, homeless, abused children, refugees, prisoners, etc.; exchange visits, camps; reintegration programs, etc.);
- Information and communication (development of facilities and resources to improve the flow of information and communications between border regions, including support for cross-border radio, television, newspaper and other media).

This program is managed in accordance with the PHARE Practical Guide. The Ministry of Foreign Affairs has overall responsibility for programming, monitoring and implementation of the SPF. The National Fund in the Ministry of Finance, headed by the National Authorizing Officer, supervises the financial management of the Program, and reports to the European Commission.

The Ministry of Foreign Affairs appoints the National Steering Committee. The Committee includes members from the sectorial ministries, representations of local authorities and NGO. Representatives from other all partner countries and the EC Delegation are invited to the meeting of the Committee in the capacity of observers. The Committee sets up of the SPF timeframe, issues Calls for Proposals, appoints the Evaluation Committee for the assessment of project applications, makes decisions on the selection of projects according to the Guidelines for Applicants and supervises the operation of the SPF. The EC Delegation approves the composition of the Committee and attends its meetings in the capacity of observer.

The Committee is assisted by the secretariat in relation to the selection and monitoring of projects. The primary function of the secretariat is to provide technical and specialist support to the

Committee and to ensure the everyday implementation and operation of the SPF. At present, the National Regional Development Agency is the secretariat of the Committee.
The main responsibilities of the Secretariat include:

- Provision of information to applicants on the PHARE SPF;
- Preparation of the Committee meetings;
- Organization of Calls for Proposals;
- Support to applicants with project preparation;
- Assistance and coordination of project evaluation process;
- Preparation of evaluation reports and draft contracts;
- Preparation of planning and management documents (guidelines, standard formats for interim and final report, etc.);
- Monitoring and inspection of implementations;
- Checking of invoices and approval of project reports;
- Reporting to the Committee;
- Updating of the joint SPF website.

The CFCU (Central Financial and Contracting Unit) under the Ministry of Finance, acts as the Contracting Authority for the SPF and is responsible for the preparation and signing of contracts, the elaboration of standard formats for financial reporting, the approval and payment of invoices, the provision of regular financial monitoring.

The EC Delegation receives, comments and approves/endorses project evaluation reports, contracts with project applicants, standard formats of financial and technical reports, copies of the minutes of the Committee meetings (only receives) and final project reports. The EC Delegation also receives regular reports on the progress of the operations of the SPF and may request additional information, independent consultants or outside auditors to assess the SPF's operations.

2. MUNICIPAL FUNDS

2.1. Business Development Funds

The main act of law regulating SME development in Lithuania is the 'Law on Small and Medium-Size Business Development' accepted 24 November 1998.[49] This document establishes the small and medium-size enterprises (SME) and forms of support applied in respect for them.[50] In accordance with Article 3 of the law, support shall be given in accordance with the Government, county or municipal small and medium-size business development programs. Those programs shall be financed from the Government and/or municipal small and medium-size business promotion funds. The main recourses for this support shall come from the state budget, municipal budgets and the Governments Privatization Fund. Certain guidelines for the procedures are also given: "Businessmen and their organizations shall draw up business development projects and carry them when taking part in the small and medium-size business development programs implemented by the Government, counties or/and municipalities.[51] The list of forms of support, which shall be available includes among others, tax credits and tax concessions, financial support from SME promotion

[49] *Law on Small and Medium-Size Business Development*, 24 November 1998, No. VIII-935, Vilnius, http://www.svv.lt/index2.php?article=178

[50] The new draft of this law is under preparation at the moment. But in proposed version main changes will concern the definition of what the small or medium-size enterprise is. There are no plans for essential changes in description of support to SME from municipalities.

[51] Article 3, *Law on Small and Medium-Size Business Development*, 24 November 1998, No. VIII-935, Vilnius, http://www.svv.lt/index2.php?article=178

funds, financial support offered by Government and local authorities in SME development programs, advisory and training services and services provided by business incubators.[52]"

In order to stimulate the development of the SME sector in Lithuania and by this, to fight increasing problems of unemployment and economic stagnation, the Lithuanian government, by decree No. 1119 September 19, 2000, ratified the Strategic Guidelines for SME Development till 2003[53] (further referred as *Strategy*) and Measures of SME Development for the Years 2000-2001[54] (further referred as *Measures*).

Strategy is the Government's vision of SME development for a limited period in the context of EU accession. In this document, the importance of SME development in regions with the highest unemployment and weak social-economic infrastructure is stressed. By asserting that the lack of funding is one of the main obstacles for SME development, this document mentions the municipality as one of the institutions implementing the measures for support to SME [55]. At the same time, the necessity to decentralize the administration of SME promotion funds and to increase the effectiveness of their use is clearly expressed.[56]

The measures for implementation of the Government strategy for the years 2000-2001 are indicated in the *Measures*. Though intended to be a plan for central government institutions, this document includes some actions important for local level. For example "to provide recommendations for local government institutions and county governors on how to prepare the SME development programs".[57]

As it is stated in the Law on Small and Medium-size Business Development, one of the recourses to support SME development is a municipal fund for SME promotion. Lithuanian local authorities, understanding the importance and direct impact of SME development in their territories on employment and generally on the social-economic welfare of their communities, has been providing support to local SMEs in different forms, and mainly by support from municipal SME promotion funds. Certain support has started already in 1995 but until 1998, there is no generalized information on the level of this support. Since 1998, the number of SME promotion funds established in municipalities has been increasing. As shown in *Chart 1*, 29 of 56 Lithuanian municipalities had created such funds in 1998, 32 of 56 in 1999, 35 of 60 in 2000[58] and 43 of 60 in 2001.[59]

[52] Article 4, *Law on Small and Medium-Size Business Development*, 24 November 1998, No. VIII-935, Vilnius, http://www.svv.lt/index2.php?article=178

[53] *Small and medium-size business development strategy till the year 2003*. Approved by Resolution No 1119 of 19 September 2000 of the Government of the Republic of Lithuania, Vilnius.

[54] *Measures of small and medium-size enterprises development for the year 2000-2001*, Approved by Resolution No 1119 of 19 September 2000 of the Government of the Republic of Lithuania, Vilnius.

[55] Article IV, §22.1, *Small and medium-size business development strategy…*

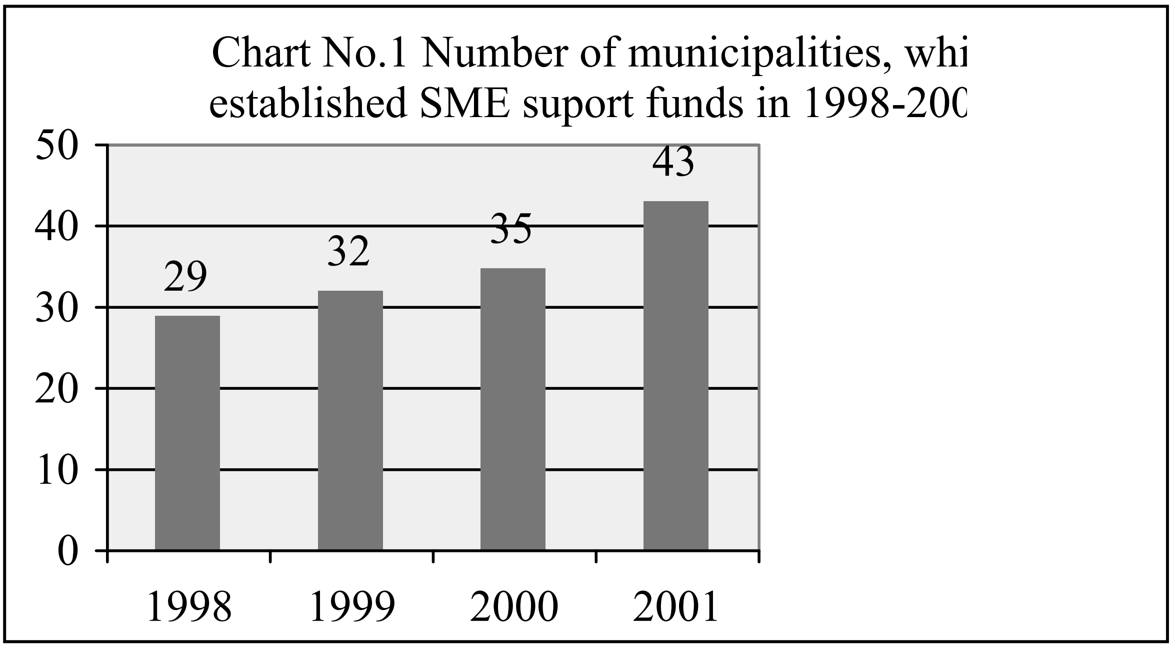
[56] Article III, *Small and medium-size business development strategy…*

[57] *Measures…*

[58] During territorial reform in Lithuania in 2000, the number of local authorities has increased from 56 to 60.

[59] Chart and information from the database of Lithuanian Development Agency for Small and Medium-Sized Enterprises http://www.svv.lt/verslo_zinynas/f_finansiniu_lesu_gavimo_galimybes.html

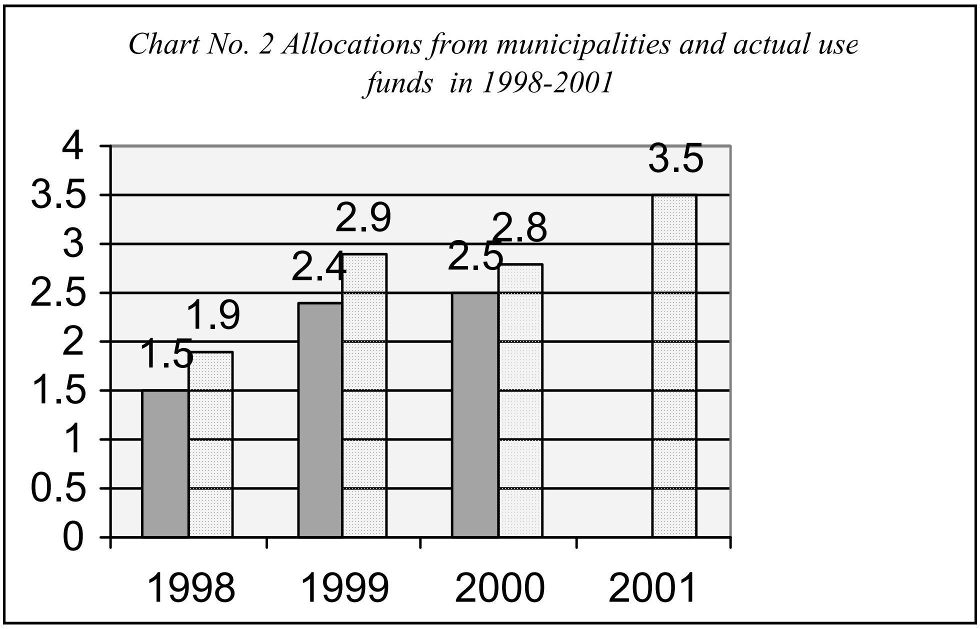
Chart 1. SME Promotion Funds in Lithuanian Municipalities



It is important to note that some municipalities even if they have not established the SME promotion funds, support local SME's by means from privatization of municipal property or other SME support programs.

During last three years, the amount of recourse provided by municipalities for support of SME's has to some extent increased as well. (*Chart 2*).[60] In the first column, the planned allocations from municipalities are shown, in the second one –the actual amount of money used.

Chart 2. Allocations from Municipalities –Planned and Used



[60] Chart and information from *the* database of Lithuanian Development Agency for Small and Medium-Sized Enterprises, http://www.svv.lt/verslo_zinynas/f_finansiniu_lesu_gavimo_galimybes.html

Year 2000 was generally a very difficult financial year both for Lithuanian state and especially for municipalities. The level of municipal revenues decreased and that influenced decrease of support to local SME's. But in 2001, when the economic situation stabilized, the planned amount of this support in municipalities increased significantly – up to 3,5 million Litas. Those plans are more optimistic also because municipalities, who have provided loans for local enterprises in the years 1998-2000, hope that the borrowed money will return to the funds.

In the table below, the size and structure of recourses of municipal SME promotion funds in year 2000 and plans for 2001 is compared.

Table IV. Allocations for Municipal SME Promotion Funds in 2000 and 2001[61]

	2000	2001
Number of municipalities with SME promotion fund	35	43
Total amount allocated,	2.8 million Lt	3.5 million Lt
Total amount used,	2.5 million Lt	No data
Largest allocation per municipality, Lt	350,000 Lt	470,000 Lt
Smallest allocation per municipality, Lt	1,000 Lt	1,000 Lt
Average allocation per municipality, Lt	80,000 Lt	81,395 Lt

As information provided in Table IV shows, there still are big differences in the size of allocations: from 1,000 Lt in a small newly established municipality as Pagėgiai to 470,000 Lt in the big industrial city-municipality, Klaipeda. In 2001, as well as in years before, instead of establishing a municipal SME promotion fund, some municipalities chose to allocate recourses for local SME's in other ways. One possibility is to create a system where a certain percent of income from privatization of municipal property goes directly to SME support (like in Ignalina municipality). Another possibility is that a municipality creates a program for support of SMEs and provides a separate line for it in the municipal budget (in this case, the recourses can come from the means of privatization as well). Some municipalities use the mixed model: part of the support goes to the fund, and a part is used for a program (Alytus city municipality). Municipalities can also provide this help through some actions improving general conditions for business – for example by creation of business incubators.

Recourses from municipal SME promotion funds in 2000 have been used mainly for:

- Credits on favorable conditions;
- Refund of interest from credits taken by SMEs;
- Training of businessmen;
- Technical assistance;
- Advertising, participation in business fairs;
- Compensation for creation of new jobs;
- Establishment of business information centers;
- Preparation of SME development strategies;

In 2001 municipalities planned to spend the funds for the same activities, mainly on provision of credits, refund of interests and training. Some new forms of support were mentioned, like support to NGOs representing interests of local businessmen, creation of databases and tax concessions.[62]

In the municipalities where SME promotion funds are established, their status and activities are regulated by the statutes of the fund. The Statute of Panevezys District SME Support Fund [63]

[61] *Savivaldybių smulkaus ir vidutinio verslo skatinimo fondų lėšų panaudojimas 2000 urban ir 2001 urban* Database of Lithuanian Development Agency for Small and Medium-Size Enterprises, http://www.svv.lt/verslo_zinynas/f_finansiniu_lesu_gavimo_galimybes.html

[62] *Savivaldybių smulkaus ir vidutinio verslo skatinimo fondų lėšų panaudojimas 2000 urban ir 2001 urban* Database of Lithuanian Development Agency for Small and Medium-Size Enterprises, http://www.svv.lt/verslo_zinynas/f_finansiniu_lesu_gavimo_galimybes.html

from February 15, 2001 will be used here as a concrete example but it to a large extent reflects the common pattern of such statutes in the most of Lithuanian municipalities. Statutes of other funds will be used in order to compare the situation and show the differences or peculiarities.

The SME Support Fund of Panevezys District Municipality (further referred as The Fund) is established by local authority but doesn't have the legal status. It uses the stamp and bank account of the administration of the municipality (article 5). That is a common status of those funds in Lithuanian municipalities.

The Fund can be created from following recourses:

- Allocation from municipal budget, determined by municipal council;
- Incomes from interest from The Fund's account in the bank;
- Recourses from international and foreign funds and organizations supporting SME development;
- Specific allocations from different sponsors;
- Own recourses of beneficiaries of The Fund;
- 30 percent of means which municipality receives after privatization of its property;
- Other (article 3).

This list is similar in the most municipal funds. The difference can be only in definition of the percentage coming from privatization means (for example, 10 percent instead of 30 percent) or exclusion of some of the recourse groups. The main part of recourses usually comes from the municipal budget or privatization means. In some cases, the fund is created only from incomes from privatization. Enterprises receiving support from municipal fund are often obligated to contribute with their own support, for example in Birstonas, the co-financing from applicants should not be less then 20 percent.[64] This is not a common requirement in municipalities. The forms of support, which can be provided in the Panevezys district, are the following:

- Credits on favorable conditions (the interest rate each year is set by the Board of municipality);
- Compensation for interests of credits, taken by enterprises (up to 5,000 Lt). Farmers can get 50 percent compensation for interests on loans not exceeding 10,000 Lt.
- Training (article 8).

All the statutes define the forms of support. Some of them choose just one or two (like Utena municipality providing almost all the funding for credits), another give a large list of possibilities. The most common support forms are refunding of interests, compensations for new jobs, credits and advertising. Provision of credits has an advantage - money can circulate from year to year and the fund is not so dependent on yearly allocations from municipality. On other hand, for very small enterprises is difficult to provide enough capital in order to guarantee the loan. Another problem is that sometimes, the cost of registering of all necessary documentation for the loan are too high compared to the benefit.[65] For those reasons, the trend during the last few years has been that the provision of loans on favorable conditions in municipalities decreased.

The Fund does not provide any support for business activities, which are listed in the Government's resolution on The List of Non-supportable Activities of SMEs[66] (like hunting, production of alcohol and tobacco, gambling etc.). Support is not provided for municipal enterprises

[63] *Smulkaus ir vidutinio verslo rėmimo fondo nuostatai*. Patvirtinti Panevėžio raj. tarybos 2001 02 15 4 šaukimo 10 posėdžio sprendimu Nr 128, Panevėžys.

[64] B*irštono savivaldybės smulkaus verslo skatinimo fondo nuostatai*. Patvirtinti Birštono sav. tarybos 2001 04 30 sprendimu Nr 112, article 17.4

[65] Interview with Utena district municipality administration

[66] *The list of non-supportable activities of small and medium enterprises*. Approved by Resolution No. 441 of 20 April 1999 of the Government of the Republic of Lithuania, Vilnius. http://www.lrs.lt/cgi-bin/preps2?Condition1=78720&Condition2=

or enterprises where the municipality owns more then 50 percent of the shares (article 14). In other statutes, the list of non eligible applicants can be much longer including different financial and legal conditions, which are required, like payment of taxes, relation to the criminal milieu, debts etc.[67]

In the statute of the fund in Panevezys district, there is no list of priorities for applicants, only conditions for applying: the activity should be not included in the non-supportable list; the enterprise has to be registered in Panevezys district; during last two years enterprise should not have had any support from The Fund (article 12). As one of the reasons why there is no priority list was mentioned (that there are quite different enterprises applying for support and there are not so many of them), the Board had to change priorities quite often. Therefore, it was decided instead to define which SME cannot apply.[68] The lack of priorities description in statutes is quite a common situation in many municipalities. Instead of defining priorities, they define ineligible areas. It is usually explained in the same way as in Panevezys. There a few enterprises applying but there is no real competition between them, and the municipality would like to support those who are applying, at least.

One basic trend is that funds do not usually support trading enterprises, but concentrate support to production and provision of services for inhabitants.[69] Other municipalities put clear priorities in the statute. For example, Birstonas municipality first supports the tourism industry and infrastructure.[70] In some local authorities, the priorities can be set by the SME development plan or strategy or other document developed in municipality. The problem is that at the moment only about 50 percent of Lithuanian local authorities has prepared or are preparing plans for SME development or have included this as part of larger plan for socio-economic development of municipality.[71]

If there are more applicants, then recourses in The Fund, the competition and the tender could be organized but the procedures are not described in detail (article 13). The situation is similar in statutes of other funds. The main reason for that is again, the small number of applicants and lack of real competition.

The procedures of decision-making and implementation in Panevezys district municipality are as follows. A Municipality establishes The Fund's commission consisting of nine members. Members of this commission are appointed from the municipal council and from the administration of the municipality. This commission prepares information for the SMEs, publishes it in local mass media, analyzes the applications and makes propositions for the municipality Board, which makes the decision. The mayor or the person nominated by him signs the agreement between the enterprise and the municipality. The municipality council has the right to stop the activities of the commission or to change its composition (articles 16-18). The Fund is administrated by The Fund's administration, which can consists of civil servants in the administration of municipality, or this right can be given to a legal person signing the agreement with municipality (article 21). At present, there is one company, Business Consultancy Center in Panevezys, which is hired to do this job.

The pattern is very similar in other municipalities. All the funds have a certain commission or committee managing the use of recourses and reporting to the political leadership of the municipality. Commissions are established by decision of municipal council and their work is regulated by statutes, adopted by municipal councils. Members of the commission can be appointed by the Council or Board. The size of commission can be different (averaging between five and ten persons). It usually includes representatives from three groups: administration of the municipality (in some cases working only as a secretariat), politicians (Council or Board members) and representatives from local business community. The proportions of each group in every municipality can vary.

[67] Statute of Širvintos municipality
[68] Interview with administration of Panevėžys district municipality.
[69] Interview with administration of Alytus city municipality
[70] B*irštono savivaldybės smulkaus verslo skatinimo fondo nuostatai*. Patvirtinti Birštono sav. tarybos 2001 04 30 sprendimu Nr 112, article 6
[71] Research done by the Association of Local Authorities in Lithuania (not published)

Representatives of businessmen are not always present in the commissions (like in Sirvintos or Anyksciai) but sometimes they can make up the main part of commission (like in Klaipeda city). Businessmen can represent either separate companies (like in Birstonas where the number of private enterprises is rather small) or general and sectorial associations of businessmen (like in Klaipeda city). In general, a clear tendency can be observed, that the local business communities are, in most cases, involved in the process of management of funds and decision-making. Some municipalities would like to give more rights to local businessmen in the steering of the funds. In Alytus city as well as in Anyksciai municipality, there are plans to create a Coordination committee or Business council consisting of representatives from the municipality and local businessmen, which would together work on programming of actions providing support to the SMEs. One of the problems is that the associated structures of enterprises in many cases are weak and passive; therefore, to find an equal partner for municipal administration to work together is not always an easy task.

When a municipality approves the statutes of commission and forms of support provided, information through local media is spread to local SMEs. Applications and all the necessary documentation have to be sent to the commission, or to administrative body of the fund, when administration is separated from the commission (like in Panevezys district). In the most cases, the technical administration of the fund is provided by one of the departments within the municipality (usually the Department of Economy). In Utena municipality, it is the Department of Finances. After receiving applications, the meetings of the commission are organized. The decision-making process is either not described (like in Birstonas) or it is defined that as a usual majority of votes (Sirvintos, Panevezys district etc.). The participation of at least half of the commission members is usually required. In most statutes, the participation of the applicant during the meetings is not described, but for example in Varena municipality this is required.[72]

Sometimes commissions are provided the right to make a decision themselves about support to certain enterprises (Anyksciai, Siauliai city), but usually this right lies with the Municipality Board (like in Panevezys, Varena, Birstonas etc.). The commission goes through all the applications, evaluates them and presents them to the Board.

Decisions of the commissions are usually published in local newspapers in order to inform the community about support provided. This was done in order to make the process more transparent, because municipalities have experienced a business community which was not always happy about how money was distributed.[73] The second reason is the possibility to give the applicant some kind of "public check", because there have been cases where, after the publication of names of companies getting support, the administration of the fund received important negative information which helped to change the decision before the final approval in the Board.[74]

In those cases where the municipality has not created a fund and support for SME's goes through special budget lines or from income from privatization, it is a municipal Board who decides how the money is going to be spent after consultations with representatives of business community (like in Ignalina). In Klaipeda municipality, where the program of support to the SME sector is approved by the municipal Board, the Commission of small-scale public procurements is responsible for the administration of that money. The representatives from the local Association of businessmen and the sectorial business associations are invited to participate in discussions.

2.2. Municipal Infrastructure Development Program

The municipal infrastructure development program was approved by Cabinet resolution No. 734, June 28, 2000, by which municipalities are entitled to submit their infrastructural projects for funding. The projects are expected to be funded from the following sources:

- International Bank of Reconstruction and Development (EUR 18.89 million loan);

[72] *Varėnos rajono savivaldybės smulkaus ir vidutinio verslo skatinimo fondo nuostatai*, article 10.13
[73] Interview with Anykščiai municipality administration.
[74] Interview with Alytus city municipality administration

- Nordic Investment Bank (EUR 20 million loan).
- European Investment Bank (EUR 15 million loan, which can also be used to co-fund ISPA projects);
- Technical assistance funds of the Governments of Sweden, Denmark and Finland;
- International loans;
- Specific allocations of Lithuanian and foreign foundations;
- Allocations of the Lithuanian state budget;
- Allocations of the municipal budgets.

Projects for funding are prepared and submitted by the municipalities, which may receive technical assistance in the preparation in cases when the project idea is compatible with the approved priorities. The initial selection of project ideas is made by the municipal boards or the mayor (i.e., the municipal executive institutions) and approved by the Ministry of Economy and then, by the Cabinet. The following projects are eligible:

- Systems of production and supply of heating;
- Primary/secondary schools and hospitals;
- Local and rural roads, bridges etc.;
- Public transportation systems;
- Water supply, sewage and sewerage systems;
- Systems of garbage collection, sorting, disposal, and use.

The project selection shall be based on the approved list of priority projects for the period of five years, based on municipal draft Master Plans, development plans and other documents.

No less than 20 percent of the costs must be funded by the municipality itself. This is liable for repayment of the governmental or international funds received. In some cases, however, the Government may allocate special grants for such repayment. According to the aforementioned Cabinet resolution No. 734, 80 million Litas are to be earmarked for repayment of loans received from this program for reconstruction of educational premises. The distribution of these funds by the municipality is presented in Table 8.

Scheme2. Phare 2000 Project - Management of Distance Learning System in Klaipeda-Taurage Region

Source: the Lithuanian Ministry of Interior, 2001.

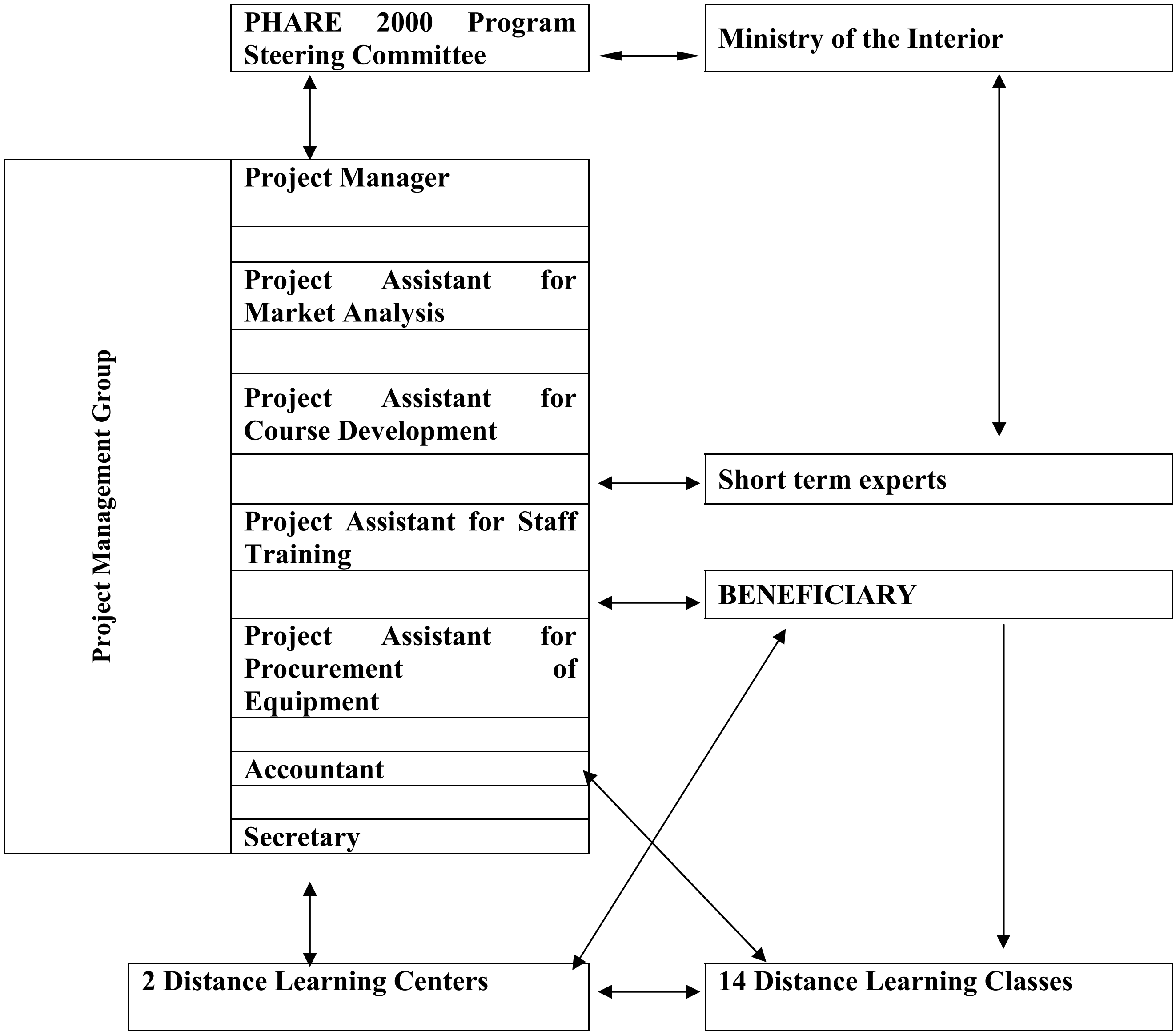


Table 1. Indicative Program for 2001 PHARE Economic and Social Cohesion

(In millions of EUR. Source: Lithuanian Ministry of Finance)

Project title	Phare funds	National funds	Total
Water supply and sewerage system development in Anyksciai	3	1	4
Water supply and sewerage systems and waste water treatment plant in Kazlu Ruda	2	0,667	2,667
Water supply and waste water collection system development in Kretinga	3	1	4
Framework for economic restructuring in Ignalina, Visaginas, and Zarasai municipalities	1.37	0.385	1.75
Innovation capacity	0.8	0.05	0,85
National tourism information and pilot tourism infrastructure in Utena region	0.87	0.22	1.09
Project preparation support facility	1.5	0	1.5
Vocational training	3.04	1	4.04
Total:	15.58	4.32	18.4

Table 2: A Regional Distribution of Government Capital Investment in 2002.

(Source: Lithuanian Ministry of Finance)

Region	Amount allocated (thousands of Lithuanian Litas)	Share in total allocations	Investment earmarked for municipalities (thousands of Lithuanian Litas)	Share of investment earmarked for municipalities in total investment allocated for the region	Co-funding of international assistance	Projects of social designation
1	2	3	4	5	6	7
Alytaus	16,716	1.4 percent	4,784	28.6 percent	2,901	1,883
Kauno	114,535	9.9 percent	14,930	13.0 percent	9,457	5,473
Klaipedos	111,571	9.6 percent	13,267	11.9 percent	7,923	5,344
Marijampoles	14,452	1.2 percent	5,200	36.0 percent	500	4,700
Panevezio	24,043	2.1 percent	13,118	54.6 percent	12,700	418
Siauliu	30,503	2.6 percent	7,646	25.1 percent	7,000	646
Taurages	19,479	1.7 percent	5,600	28.7 percent	5,600	0
Telsiu	5,551	0.5 percent	1,744	31.4 percent	0	1,744
Utenos	22,625	2.0 percent	4,638	20.5 percent	500	4,138
Vilniaus	424,639	36.7 percent	81,758	19.3 percent	71,469	10,289
Lithuania (i.e., investment without regional location)	370,935	32.1 percent	0	0.0 percent	0	0
Foreign countries	1,877	0.2 percent	0	0.0 percent	0	0
TOTAL	1,156,926	100.0 percent	152,685	13.2 percent	118,050	34,635

Notes: 1. Regional investment package (column 2) includes all state capital investment allocated by the state, whether managed by the central government or by regional/local authorities.

2. Investment earmarked for municipalities includes capital funds which the central government transfers to the municipalities and which shall be managed by the municipalities (a part of allocations in column 2).

3. Share of municipal investment (Column 5) includes the share of capital funds, which were allocated by the central government to the municipalities of that region, compared to the total investment in that region.

4. Co-funding of international assistance (Column 6) includes funds which the central government allocated to co-fund international assistance initiatives, primarily EU structural aid (a part of allocations in column 2).

Table 3. SAPARD Allocations 2000-2006

(In EUR. Source: Lithuanian Ministry of Agriculture.)

Measures	Total	EU Contribution	National Public Contribution	Private Contribution
Measure 1. Investment in agricultural holdings	276,295,486	97,408,318	32,469,441	146,417,727
Measure 2. Improving the processing and marketing of agricultural and fisheries products	129,424,958	43,680,924	14,560,308	71,183,726
Measure 3. Development and diversification of economic activities	45,485,786	17,056,407	5,686,486	22,742,893
Measure 4. Improvement of rural infrastructure	52,480,016	32,275,215	10,758,405	9,446,396
Measure 5. Reforestation of agricultural land and improvement of forest infrastructure	20,498,670	7,687,763	2,561,572	10,294,335
Measure 6. Environmentally friendly agricultural methods	2,832,227	2,124,171	708,056	0
Measure 7. Vocational training				
Measure 8. Technical assistance, information and publicity	4,968,572	3,726,429	1,242,143	0
campaigns	5,664,442	4,248,335	1,416,107	0
	537,650,157	208,207,562	69,402,518	260,040,077

Table 4. State Investment Program in 1999-2002, Source of Funding

(In Millions of Lithuanian Litas).

	Year 1999	Year 2000	Forecast, Year 2001	Forecast, Year 2002
State investment (total)	3,051.9	2,082	1,269	1,812.8
Percentage of GDP	7.2 percent	4.7 percent		
Funds from the state budget	211.2	85.2	313.3	627.5
Funds from the Privatization Fund	270.9	336.6	227	200
Governmental loans	1,280.9	525.3	410	148.2
Loans guaranteed by the Government	838.6	893.8	318.7	181.2
ISPA (environmental grants)				98.4
ISPA (transport grants)				185.1
PHARE				143.9
Other international financial institutions	168	81.5		21.7
Own funds of investment managers	282.3	159.6		206.8

Source: Lithuanian Ministry of Finance.

Notes: In this table 'Government' refers to the central government

Table 5. State Investment Program in 2000, Breakdown by Manager of Allocations

(In Thousands of Lithuanian Litas)

Managers	State budget			Privatization Fund			Loans taken by the state			Loans taken with the State guarantee			Non returnable Foreign aid			Other funds		
	Planned	Paid	Delivered	Planned	Paid	Delivered	Planned	Paid	Delivered	Planned	Paid	Delivered	Planned	Paid	Delivered	Planned	Paid	Delivered
Total:	101188	97340	57640	335116	304661	258809	540619	336829	306217	790634	211053	199585	83457	64683	67126	159400	187380	217441
Government	2004	2004	1969	6108	5968	3369	0	0	0	0	0	0	0	0	0	0	0	0
Ministries	48529	46783	25598	93958	86139	76508	79645	66735	61555	80549	17521	23569	2500	4652	4293	0	0	
County Governments	40480	40481	19081	17399	16426	8763	867	876	867	0	0	0	0	0	0	0	0	
Departments, Services, Inspections	2991	1590	1124	12838	12828	11339	94	92	0	119495	97551	96488	0	0	0	0	0	
Enterprises, Organizations	2691	1939	4948	91792	85589	80875	330130	260891	236002	513170	43429	34214	14500	40111	41809	157400	168203	201927
Courts and judiciary	30	80	74	8231	6670	5473	1000	1000	0	0	0	0	0	0	0	0	83	83
Educational, Cultural and Other organizations	2463	2463	2846	27038	25971	18372	114	114	114	0	0	0	0	0	0	0	299	439
Municipal Projects	2000	2000	2000	77752	65070	54110	84653	7130	7679	56420	52552	45314	66457	19920	21024	2000	14018	9998

Source: Lithuanian Ministry of Finance

Notes: 1. Column 'Planned' reflects capital investment figures planned and approved at the beginning of the budgetary year

2. Column 'Paid' reflects capital investment amounts actually paid by the end of the budgetary year

3. Column 'Delivered' reflects capital investment amounts, for which work was actually delivered.

Explanation. If there is any discrepancy between amounts paid and amounts, for which actual work was delivered, this means that either additional amounts shall be paid next year, or additional work shall be delivered next year

Table 6. The Sequence of the Preparation of the State Investment Program in 2001

(based on procedure approved by Cabinet Resolution No. 478 of April 26, 2001 "On the Approval of the Order of Planning, Concretizing, Using, Accounting and Controlling State Investment Earmarked for Capital Investment".)

Date	Responsible institution(s)	Work Result
05.03.2001	The Cabinet	Concretizes, if necessary, strategic priorities and guidelines of fiscal policy.
	The Statistics Board	Presents the data for the year 2000 based on the list of macroeconomic forecasts (indicators) prepared by the Ministry of Economy and approved by the Statistics Board.
10.03.2001	Ministries of Economy, Foreign Affairs, Interior	Forecast the indicators of investment, directions of investment and sources of financing.
15.03.2001	All managers of allocations	Present to the Ministry of Finance the information on: proposed programs; loans returned or to be paid; projects proposed for the State Investment Program; information on the results of the implementation of programs in the previous year
15.03.2001	The state enterprise 'State Property Fund'	Submits to the Ministry of Finance the data on forecasted Privatization Fund's income from privatization deals.
26.03.2001	Ministries	Prepare sector development strategies and submit them to the Ministries of Economy and Finance.
01.04.2001	Ministry of Finance	Prepares forecasts for 2002-2004, including GDP by fields of activity, elements of income and expenditure.
15.04.2001	Ministry of Transport	Presents forecasts of the road maintenance and development program for 2002-2004.
15.04.2001	State and governmental institutions	Present to the Ministry of Finance data on needs for state budget allocations.
15.04.2001	Ministry of Economy	Prepares general development strategy and proportions of investment and submits them to the Cabinet's strategic planning committee.
01.05.2001	Ministry of Finance	Presents to the Cabinet's strategic planning committee: consolidated fiscal indicator forecasts (revenues, expenditures, deficit, debts); a draft of major macroeconomic indicators for 2002-2004; a draft of major preliminary indicators of national budget; a draft law on approval of indicators for determination of municipal budget amounts and equalization in 2002-2004; a draft of major principles for establishment of allocation maximums; data on EU structural aid co-financing.
15.05.2001	The Cabinet	Approves forecasts of: major macro-economic indicators, preliminary figures of national budget, general principles for establishment of allocation maximums, amounts for co-financing EU structural funds, state investment ceiling amounts.
25.05.2001	Ministry of Finance	Informs managers of allocations on the foreseen amounts of allocations.
20.06.2001	All managers of allocations	Submit to the Ministry of Finance: strategic activity plans, draft estimates of state budget programs for 2002-2004, including preliminary calculations of requested allocations, etc.
20.06.2001	Ministries and government institutions	Submit to the Cabinet office and the Prime Minister's office strategic activity plans, including plans of subordinated institutions, and generalized information on programs.
20.06.2001	Ministry of Finance	Submits to the Cabinet office and the Prime Minister's office outline draft of the State Investment Program

Table 6.(cont'd) The Sequence of the Preparation of the State Investment Program in 2001
(based on procedure approved by Cabinet resolution No. 478 of April 26, 2001 "On the Approval of the Order of Planning, Concretizing, Using, Accounting and Controlling State Investment Earmarked for Capital Investment".)

20.06.2001	State institutions and organizations	Submit to the Ministry of Finance the general development strategy and draft programs, which comply with strategic priorities.
20.06.2001	Ministry of Interior, other institutions, including Association of Local Authorities	Submit to the Ministry of Finance indicators necessary to distribute funds earmarked for equalizing structures of municipal revenues.
02.07.2001	Ministry of Finance	Submits its conclusions to Cabinet's strategic planning committee on strategic activity plans of allocations managers.
02.07.2001	Cabinet Office and Prime Minister's Office	Present conclusions on strategic activity plans and generalized outlines of budgetary programs to Cabinet's strategic planning committee.
05.07.2001	Managers of allocations with borrowed funds	Submit to the Ministry of Finance data on loans returned or to be re paid (each respective loan separately).
20.07.2001	All managers of allocations	Concretize strategic activity plans, estimated of the budgetary programs, and applications for funding, and submit these to the Ministry of Finance.
20.07.2001	Institutions in charge of EU structural aid	Concretize programs and submit them to the Ministry of Finance.
07.09.2001	Ministry of Finance	Prepares and submits to the Lithuanian Cabinet drafts of financial indicators of the state and municipal budget, the draft State Investment Program, and the related drafts of tax legislation.

Table 7. The Budget of the Roads Fund in 2001

(In thousands of Lithuanian Litas, approved by the Cabinet Resolution No. 147, 8 February 2001. Abbreviated version.)

No. of item	Designation of the funds	Amount of the funds
	Funds earmarked for construction, modernization, maintenance of automobile roads, programs of infrastructure for bicycles and other motorless vehicles, programs of safe traffic, other measures of infrastructure and safe traffic, of which:	625000
	Funds earmarked to pay for the work done in 2000 on national and local roads, which were not paid in 2000 due to the lack of funds	87000
	Compensation of international bank loans (funds lost due to fluctuations of currency rates)	16800
	Total earmarked for construction, modernization, maintenance of automobile roads, programs of infrastructure for bicycles and other motorless vehicles, programs of safe traffic in 2001, of which:	538000
1	Construction, modernization, reparation of roads, safety measures, of which:	354610
1.1	Construction, modernization and reparation of roads	80610
1.2	Construction, reconstruction and reparation of bridges	17000
1.3	The program of asphalt works on gravel roads	6000
1.4	Lithuanian share in international projects	20000
1.5	Interest on loans to finance projects ‘Via Baltica’, projects for construction of fast roads, other transport programs	55000
1.6	Maintenance of roads	176000
2	Technical control of construction, reparation and maintenance of roads, special analysis, laboratory works	2900
3	Preparation of projects of roads, expertise, preparation of roads’ development programs, scientific work, of which:	10900
3.1	Projects and expertise	6400
3.2	Programs, scientific work	4500
4	Expenses for the purchase of land, removed or destroyed buildings and constructions, plants and other property to be compensated during construction or reparation of roads	2000
5	Purchase of technical equipment	12200
6	Development of infrastructure (WCs, leisure places etc.)	600
7	Works of environmental protection, ecology, land re cultivation, necessary during construction of reparation of national roads	3500
8	Purchase and exploitation of buildings necessary for reparation and maintenance of roads	6500
9	Liquidation of disasters on national roads	500
10	Maintenance of institutions in charge of construction, reparation or maintenance of roads, which are not maintained from the state budget	4025
11	Formation of data bank of roads during the reparation and maintenance works	880
12	Preparation of contracts, organizing tenders etc.	100
13	Cooperation with foreign partners	100
14	Preparation of relevant legal acts, documents, standards	385
15	Purchase of transport weighing equipment and control of transport duties on national roads	100
16	Preparation and implementation of traffic safety programs	2500
17	External lighting of roads, traffic regulation and management, warming of road surface	700
18	Construction and maintenance of motorless traffic infrastructure	1000
19	Construction, reparation and maintenance of local roads, roads in forests and national parks	107600
20	Other needs	26900

Table 8. Distribution of Funds Earmarked for Reconstruction of Premises of Educational Institutions from the Municipal Infrastructure Development Program

(In Lithuanian Litas, approved by Order No. 167, 8 February 2001, of the Lithuanian Minister of Education)

Municipality	Number of pupil (units)	Share of funds based on the number of pupil	Total size of premises	Share of funds based on the size of premises	Total share of funds
A	1	2	3	4	5
IŠ VISO	580,072	40,000,000	4880.2	40,000,000	80,000,000
1. Vilniaus urban	82,874	5,714,739	599.5	4,913,733	10,628,472
2. Kauno urban	57,346	3,954,406	394.7	3,235,113	7,189,519
3. Klaipedos urban	31,256	2,155,319	207.2	1,698,291	3,853,610
4. Siaulia urban	23,459	1,617,661	166.8	1,367,157	2,984,818
5. Panevezio urban	21,670	1,494,297	136.9	1,122,085	2,616,382
6. Alytaus urban	13,531	933,057	96	786,853	1,719,910
7. Palangos urban	3,321	229,006	28	229,499	458,505
8. Visagino urban	6,383	440,152	58.7	481,128	921,280
1. Akmenes rural	5,511	380,022	47	385,230	765,252
2. Alytaus rural	4,164	287,137	52.2	427,851	714,988
3. Anykscia rural	5,677	391,469	63.1	517,192	908,661
4. Birstono	1,013	69,853	7.1	58,194	128,048
5. Birza rural	6,002	413,880	68.7	563,092	976,971
6. Druskininka	4,804	331,269	36.1	295,890	627,159
7. Elektrėnų	5,017	345,957	42	344,248	690,205
8. Ignalinos rural	3,396	234,178	47.8	391,787	625,965
9. Jonavos rural	9,043	623,578	81.7	669,645	1,293,222
10. Joniskio rural	5,887	405,950	48.3	395,885	801,835
11. Jurbarko rural	6,882	474,562	74.8	613,090	1,087,651
12. Kaisiadorie rural	5,847	403,191	57	467,194	870,385
13. Kalvarijos	2,348	161,911	21.2	173,763	335,674
14. Kauno rural	12,652	872,443	97.3	797,508	1,669,952
15. Kazly Rudos	2,637	181,839	21.3	174,583	356,423
16. Kelmes rural	7,340	506,144	67.6	554,076	1,060,220
17. Kedainie rural	10,909	752,251	94	770,460	1,522,712
18. Klaipedos rural	7,909	545,381	84.1	689,316	1,234,697
19. Kretingos rural	8,003	551,863	64.1	525,388	1,077,251
20. Kupiskio rural	4,466	307,962	49.9	409,000	716,961
21. Lazdije rural	4,535	312,720	58.6	480,308	793,028
22. Marijampoles	12,099	834,310	91.9	753,248	1,587,558
23. Mazeikia rural	12,922	891,062	104.7	858,162	1,749,223
24. Molete rural	4,045	278,931	45	368,837	647,768
25. Neringos	378	26,066	3.4	27,868	53,933
26. Pagegių	2,417	166,669	22.6	185,238	351,907
27. Pakruojo rural	5,111	352,439	54.5	446,703	799,142
28. Panevezio rural	5,847	403,191	64.8	531,126	934,317
29. Pasvalio rural	6,127	422,499	61.2	501,619	924,118
30. Plunges rural	8,514	587,100	63.1	517,192	1,104,291
31. Priene rural	5,823	401,536	54.5	446,703	848,239
32. Radviliskio rural	9,473	653,229	101.6	832,753	1,485,982
33. Raseinie rural	7,709	531,589	69.8	572,108	1,103,697
34. Rietavo	2,060	142,051	19.9	163,108	305,159
35. Rokiskio rural	7,063	487,043	73.4	601,615	1,088,658
36. Skuodo rural	5,227	360,438	48	393,426	753,865
37. Sakie rural	7,123	491,180	65	532,765	1,023,945
38. Salcininke rural	6,000	413,742	66.5	545,060	958,801
39. Siaulie rural	8,064	556,069	65	532,765	1,088,834
40. Silales rural	6,729	464,011	57	467,194	931,205
41. Silutes rural	10,831	746,873	101.6	832,753	1,579,626

Municipality	Number of pupil (units)	Share of funds based on the number of pupil	Total size of premises	Share of funds based on the size of premises	Total share of funds
A	1	2	3	4	5
42. Sirvinto rural	3,554	245,073	30.1	246,711	491,784

Table 8. (Cont'd) Distribution of Funds Earmarked for Reconstruction of Premises of Educational Institutions from the Municipal Infrastructure Development Program

(In Lithuanian Litas, approved by Order No. 167, 8 February 2001, of the Lithuanian Minister of Education)

Municipality	Number of pupil (units)	Share of funds based on the number of pupil	Total size of premises	Share of funds based on the size of premises	Total share of funds
43. Svencionio rural	5,145	354,784	51.2	419,655	774,438
44. Taurages rural	9,730	670,951	76.1	623,745	1,294,696
45. Telsie rural	10,612	731,771	100.9	827,015	1,558,787
46. Traka rural	6,352	438,015	57.1	468,014	906,028
47. Ukmerges rural	8,011	552,414	77.4	634,400	1,186,814
48. Utenos rural	8,761	604,132	96.7	792,590	1,396,722
49. Varenos rural	4,777	329,407	53.8	440,966	770,373
50. Vilkaviskio rural	9,016	621,716	70.1	574,567	1,196,283
51. Vilniaus rural	12,720	877,132	113.6	931,109	1,808,242
52. Zarase rural	3,950	272,380	48	393,426	665,806

Table 9. Approved ISPA Projects, 2000-2001

(In EUR. Drafted by the Lithuanian Ministry of Finance, 2002)

	Measure number	Title	Project Amount	ISPA	
				Amount	Percent
1	2000/LT/16/P/PT/001	Upgrading of IXB Transport Corridor	26,082,400	19,561,800	75
2	2000/LT/16/P/PT/002	Development of Via Baltica road in 2000-2003 (Pa European Corridor I)	15,438,667	11,579,000	75
3	2000/LT/16/P/PT/004	Modernization of telecommunications, signaling and power supply	31,701,000	11,412,360	36
4	2000/LT/16/P/PT/003	Development of Corridor 1A (2001 -2004)	26,422,400	19,816,800	75
5*	2001/LT/16/P/PT/005	Modernization of Telecommunications, power supply and signaling on Crete Corridor No, IX B-Power Sector 3	27,193,000	11,984,920	44
Total Transportation			126,837,467	74,354,880	59
Percentage Rate			50	52	X
1	2000/LT/16/P/PE/001	Rehabilitation and extension of water Supply and Sewage Collection Systems in Vilnius (Stages 1 and 2)	40,000,000	20,000,000	50
2*	2000/LT/16/P/PE/002	Druskininkai: wastewater treatment, upgrading and extension	5,500,000	2,750,000	50
3*	2001/LT/16/P/PE/003	Alytus: development of regional waste management	7,825,808	3,912,904	50
4*	2001/LT/16/P/PE/004	Taurage: regional waste management system	6,629,788	4,640,850	70
5*	2001/LT/16/P/PE/005	Jonava: wastewater treatment plant, sewer network	6,259,900	3,755,940	60
6*	2001/LT/16/P/PE/007	Kaunas: extension of wastewater treatment plant	31,914,000	15,874,890	50
7*	2001/LT/16/P/PE/006	Neringa: wastewater treatment plant, sewer network	10,153,000	4,771,910	47
8*	2001/LT/16/P/PE/008	Siauliai : development of regional waste management	9,390,000	5,265,120	56
Total Environment			117,672,496	60,971,614	52
Percentage Rate			46	43	x
1	2000/CE/16/P/AT/006	TA for the organization of a seminar in the Republic of Lithuania on Environment Impact Assessment	3,737	3,737	100
2	2001/CE/16/P/AT/002	Support for the organization of Monitoring Committees	70,000	70,000	100
3	2001/LT/16/P/PA/001	TA for Development of Railway Crete Corridors No IXB, IXD and I	1,250,000	937,500	75
4*	2001/LT/16/P/PA/002	TA project preparation in environment sector	9,350,000	6,997,500	75
Total Technical Assistance			10,673,737	8,008,737	75
Percentage Rate			4	6	x
17	TOTAL (Transportation + Environment+ Technical Assistance)		255,183,700	143,335,231	56

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Investing in Regional Development:

Policies and Practices in Poland

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Inventory of Financial Flows for Regional Development and Local Public Services

Introduction

This report was completed in December 2001 but the authors were able to include all updated data. The majority of the information included in this report is based on data from 2000. However, in 1999, Poland changed its administrative structure and two new levels of self-government appeared: counties and regions. This means that only recently the self-government sector and its role have increased significantly. Despite their newness, the new self-government units joined the process of supporting local and regional development. The effects of this appear in data from 2000 – the second year of counties' and regions' operation. The inventory allowed the Institute team to recognize real streams of money supporting capital investment on the local and regional levels. It "opened eyes" to the critical role of infrastructure enterprises in financing capital investment in infrastructure and to the modesty of the foreign aid financing of this sphere in Poland. The inventory reveals a significant developmental effort of local governments in Poland and the role of the banking industry in supporting this effort.

The report uses the terminology of the Main Statistic Office. In numerous publications, the same Polish terms are interpreted into English in different ways. We prefer official statistic terminology instead of independent translations.

One important issue is the names of local governments in Poland. To avoid confusion, we explain our translations here. We have three levels of local governments, but four types of self-government units. They are:

Gminy – (fundamental self government unit, sometimes translated into English as *gminas* or communes) – in this report we call them communities (rural entities) and municipalities (urban entities) or in uniformed way: communities/municipalities.

Powiaty – (second level of self-government with different competencies; the area of one such unit contains several communities and municipalities) – in this report we call them *counties.*

Miasta na prawach powiatu - (cities with county rights - these units perform both the duties of municipalities and of counties; this form refers to larger cities) – in this report we call them *cities with county rights.*

Województwa - (sometimes translated into English as voivodships; these are larger territorial entities with regional competencies) – in this report we call them simply: *regions*.

The report consists of four chapters: a description of the public finance system used at local and regional levels, a presentation of statistic data on capital investment financing, a description of mechanisms of capital investment financing in Poland and the evaluation of how different mechanisms meet their objectives.

The authors appreciate all comments and suggestions concerning this report.

1. Public Finance System at the Local and Regional Levels[1]

Budget incomes of the Municipality, County and Region are regulated by the "Law On Territorial Self-government Unit Income," dated November 26, 1998[2]. According to this Law, public incomes on local and regional levels are composed of three main sources:

- Local-regional government units' public revenues, which amounted to 41.7 percent of total incomes in 2000;
- Allocations, which amounted to 22.7 percent of the local-regional budgets' incomes;
- General subsidies, which amounted to 35.6 percent of the revenues [3].

Local-Regional Government Revenues

Local-Regional governments' revenues are the most important source of budgetary income and last year constituted nearly half of all the income of local governments. These revenues are composed of the following components:

- Share of personal and corporate income taxes. That share, different for each unit is as follows:

	Personal Income Tax	Corporate Income Tax
Municipality	27.6%	5%
County	1.0%	0%
Region	1.5%	0.5%

Their share of taxes collected by the national budget contribute 13.8 percent to revenues of local government units. Among those taxes definitely the most important are personal income taxes which contribute to 12.4 percent of revenues.

- Revenues from local taxes. These include real estate tax, commercial vehicle tax, legacy and gift tax, agriculture and forests taxes, flat-rate tax paid by selected family micro-enterprises. Among the local taxes, the most important is the real estate tax, which brought 9.2 percent of all incomes of the local governments in Poland. Other taxes contribute between 0.1 percent (forest tax) up to 1 percent (agriculture tax) to local and regional incomes. Municipalities can decide about the level of local taxes up to legally established ceiling. Local authorities are also authorized to apply individual exemptions and incentives concerning local taxes.
- Revenues from fees, including stamp, duty and administrative fees. Fees collected by local government units contributed 2.7 percent to the incomes in the year 2000.
- Revenues on assets, especially property owned by municipalities. Those include rent on real estate owned by municipalities. Income on assets contributed last year (2000) amounted to 7 percent of total income.
- Other revenues, include interest on financial capital, bank deposits, income from privatization, revenues of communal companies and other enterprises owned partly by local self-government units and income on fines. This income contributed 6.8 percent to the total income.

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[1] Description is based on the legal situation in 2001.
[2] "Dziennik Ustaw no 150 z 1998 with changes in "Dziennik ustaw" no 160, 2000 and Dziennik Ustaw no 55, 39 and 95 2001 .
[3] Report on the budget execution of the territorial self governments Units in 2000. Ministry of Finance 2001.

Allocations

An allocation is defined as a financial transfer, mostly from national governments to local and regional authorities to fulfill a designated task, including capital investment tasks. Local and regional governments can use them for only specified tasks, which are targeted by the financing institution. They are divided into two main groups, based on the division of responsibilities between territorial self-government units and the national administration:

- Allocations providing co-financing of the local government works, (e.g., those related to social aid medical assistance, public safety – 8.2 percent of incomes in 2000);
- Allocations covering the costs of works, which should be executed by the national administration but, according to mutual agreements, are executed by municipal, county or regional authorities – 12.2 percent of incomes in 2000.

Those two groups of subsidies contributed nearly 90 percent to all subsidies. The remaining allocations are those used for designated tasks executed on the basis of agreement with other local self-government units. According to the law, the local government which executes the tasks of an other unit (e.g., a municipality, which executes the task of a county or region should conclude the agreement and obtain the allocation for the amount specified in the agreement[4]). This also includes subsidies obtained from Appropriated State Funds, like the Fund for Environmental Protection. This last item is relatively small (0.4 percent of income in the year 2000) but 75 percent of it is used for financing capital investment.

General Subsidies

General Subsidies play an important role in supplementing local/regional revenues from taxes. The Constitution specifies that territorial self-governments should receive revenues that allow them to fulfill designated tasks. Since local taxes and fees combined with their share of PIT and CIT are not sufficient, general subsidies are necessary. Contrary to allocations, they can be used more flexibly by local and regional authorities. Income obtained as a general subsidy can be spent at the discretion of the local/regional council. General subsidies can be divided into three parts, which differ amongst the levels of the governments. Municipalities obtain a fundamental part of the general subsidy, which plays an important role in diminishing disparities between units with high and low tax income. The total amount of the fundamental part of the general subsidy to all municipalities is composed of not less than 1 percent of the national budget income and the total amount paid by municipalities with tax income 150 percent above the average[5]. The fundamental part of this general subsidy is later divided into two funds :

- A fund for diminishing disparities, which is paid to municipalities and communities with tax income 85 percent lower than the average;
- The remaining amount is distributed between all municipalities based on their number of inhabitants.

Municipalities and communities also obtain an educational part of the general subsidy for maintenance of educational units and as compensation for their part of the general subsidy. This mostly compensates the personal car transportation tax, which was replaced by an increased excise tax. It also compensates for lower income related to tax incentives.

[4] Law on revenues of the territorial self government units, chapter 46.
[5] For the year 2001. In years 1999 and 2000 these figures were different

Counties obtain an educational part of the general subsidy for high schools, a highway part of the general subsidy for maintenance of the roads and an equalizing part of the general subsidy to diminish the difference in tax revenues between local governments. The equalizing part of the general subsidy is transferred to counties that have a lower per capita share in PIT than the one with the highest in Poland (Warsaw County). This is compiled with a special indicator related to the highest PIT recipient in Poland. Counties obtain 85 percent of the difference between the highest per capita share in PIT and the per capita share in the given county multiplied by the number of inhabitants.

Regions obtain general subsidies divided into three parts: Educational, for college level education; Highway and Equalizing parts, for those regions which have a lower share in PIT and CIT than the highest recipient in the Polish region. Recipient regions obtain 70 percent of the difference between the highest per capita share in CIT and PIT and the given region's per capita share multiplied by the number of its' inhabitants.

The Educational and Highway parts of the general subsidy constitute 84 percent of all subventions transferred to municipalities, communities, counties and regions. Last year (2000), those subventions amounted to USD 5.38 billion. The Educational subvention was much larger amounting to USD 48 billion, while Road subvention was USD 0.58 billion.[6]

2. Local and Regional Investment Expenditures – Analysis of Statistical Data

The analysis of statistic data presented here is based on available information from domestic sources. The primary source of this information is the Main Statistic Office, which collects the statistical reports of local governments concerning budgetary plans and spending. Starting from 1999, the Ministry of Finance also began collecting and analyzing data on local government budgets due to the new methodology of counting public finance-system deficit. In 1996, the debt of local governments was growing rapidly and the accounting of only the state government deficit proved to be insufficient to accurately show the situation of the public finance system. The third source of information is the Committee for European Integration, which monitors the spending of EU developmental aid.

While analyzing data on capital investment, it is necessary to underline, that in the period of 1990-1998 there was only one level of local government in Poland – communities (municipalities). In 1999, two new levels were created: counties and regions. In fact, a fourth category appeared in budgetary statistics: cities with county rights. This category contains cities, which have joint competencies as a community and a county. Different units affect capital investment on local and regional levels. The most important are local governments and infrastructure companies. In this chapter, we are not interested in capital investment of enterprises, except for infrastructure. This means that the expenditures of this kind here presented could, in reality, be lower because some expenditures of the commercial sector and of individuals could not be taken into account.

From the numerous statistical divisions of local and regional capital investment, we decided to concentrate on data of the year 2000. The situation concerning this year is presented in a more detailed way. We also decided to present dynamic data. All data are presented in current prices. Unfortunately, it is necessary to note that Poland was a place of significant inflation. However, we decided not to present data in constant prices but to re-

[6] Report on the budget of territorial self government units in 2000. Ministry of Finance 2001.

account data from zloty into ECU or euros based on the exchange rate of Polish zloty (PLN) into ECU or euros, from the last day of the given year. Of course, this is a simplification but it allows for presentation of data comparative to that used in the European Union. We think this comparison allows for better understanding of the value and significance of capital investment in Poland. The following tables contain data on the following issues:

1) Changes in capital expenditures of local governments and infrastructure companies within the period of 1993-2000;
2) Capital investment expenditures of local governments and their sources of financing in 2000;
3) Budgetary situation of local governments in 2000;
4) Comparison of capital investment of local governments per capita in different regions and different local government levels in 2000.

Much more statistical information is contained in each chapter concerning detailed sources of financing. The first table contains data on the value of capital investment expenditures of local governments and infrastructure companies within the period of 1993-2000 in constant prices in PLN and ECU/euro.

Table 1. Capital Investment Expenditures of Local Governments and Infrastructure Companies

Capital Investment Expenditures	1993	1994	1995	1996	1997	1998	1999	2000
Local governments (ECU/Euro equivalent)	2,435 (1,018)	3,364 (1131)	4,658 (1,473)	7,056 (1,983)	9,680 (2,496)	8,176 (1,991)	12,562 (3,013)	13,532 (3,497)
Supply of electricity, gas, heat and hot water, water supply and purification (ECU/Euro equivalent)	3,570 (1,492)	4,869 (1,637)	6,768 (2,140)	8,770 (2,464)	10,026 (2,586)	10,255 (2,497)	10,606 (2,544)	9,138 (2,361)
Post and telecommunications (ECU/Euro equivalent)	1,482 (619)	1,723 (579)	2,590 (819)	3,938 (1,107)	6,474 (1,670)	8,402 (2,046)	9,446 (2,266)	10,320 (2,667)
TOTAL domestic in M PLN (ECU/Euro equivalent)	7,487 (3,129)	9,956 (3,347)	14,016 (4,432)	19,764 (5,554)	26,180 (6,752)	26,833 (6,534)	32,614 (7,823)	32,990 (8,525)
Exchange rate PLN/Euro	2,393	2,974	3,162	3,558	3,877	4,107	4,169	3,870

Source: Ministry of Finance, Main Statistic Office

The data included in the table above show, that within the period of 1993-2000, the capital investment expenditures of local governments and infrastructure companies increased by 172.5 percent in euro values. An especially fast increase (of 243.5 percent) was observed in capital expenditures of local governments. The increase of capital investment in supplies of electricity, water, gas heat and sewage treatment amounted to 58.2 percent. The increase of capital investment in postal and telecommunications amounted to 330.9 percent. The presented data show that capital investment expenditures used for local and regional development increased significantly. For the year 2000, the total approved for Poland PHARE assistance amounted to 490 million EUR[7]. This assistance constituted about 5.7 percent of total developmental expenditures on local levels in Poland. However, not all EU assistance had regional character. The presented data show that local governments and infrastructure companies in Poland have significant financial potential for capital investment.

Local governments affect an especially important part of capital investment through their budgetary expenditures. In Poland, there are not secondary data on the methods of financing

[7] It does not mean that this amount was spent on local capital investment.

capital investment in local governments. To count the proportions in which particular sources are used to finance capital investment of local government, we used the following procedure:

1. Several budgetary incomes are designated in concrete amounts to capital investment or long-term uses: allocations executed for capital investment, increase of long-term bank credits, increase of long-term non-bank loans, increase in Municipal bonds issued (new sales minus repayments). We accepted all sums designated long-term as serving capital investment financing.
2. Secondly, we accepted the rule that all remaining local government incomes with no specified direction of spending contribute to capital investment financing in the same way as they contribute to all expenditures. This means that incomes with non-specified direction of spending contributed to the capital investment proportionally to their size.

The results of accounting for how particular sources of financing of local governments contribute to capital investment are presented in the table below. The data used were taken from the Ministry of Finance.

Table 2. Capital Investment Expenditures of Local Governments and Estimations of Financing Sources

Item	PLN-in thousands	In %
Capital Investment Expenditures	13.532.028	100.00
Sources of Financing	-	-
Public Revenues	4.421.580	32.65
General Subsidies	3.735.690	27.61
Allocations for Capital Investment*	2.717.510	20.10
Long-term Bank credits*	1.647.637	12.18
Long-term Loans*	502.868	3.72
Municipal Bonds*	227.494	1.68
Surplus form Previous Years	161.981	1.21
Other Incomes	107.144	0.79
Privatization Incomes	8.437	0.06
Sales of Securities	1.687	0.01
Total Sources of Financing	13.532.028	100.00

Source: Ministry of Finance and own estimations, * incomes with dedicated direction of spending

According to data in the above table, the primary source of capital investment financing of local governments in 2000 was their public revenues. Based on the accepted rule, they financed 32.65 percent of all capital investment of local governments. The secondary source of financing was general subsidies (coming from the central budget and supporting municipality revenues). This financed 27.61 percent of total capital investment of local governments in Poland in 2000. Both sources had non-specified direction of spending which means that local governments in Poland had relatively high control to increase capital investment from their incomes with non-specified direction of spending. The debt instruments allowed for 17.58 percent capital investment financing in 2000. Among the debt instruments, a critical role was played by bank credits. The other sources of capital investment financing were less important.

Because debt sources are becoming the third most important sources of capital investment financing it seems to be important to present the level of deficit of different levels of local governments. These data are included in the below table.

Table 3. Incomes and Outcomes of Local Governments in Poland

Item	Total Local Governments	Communities/ Municipalities	Counties	Cities with County Rights	Regions
Incomes	72,610	34,584	12,555	21,766	3,705
Public Revenues	30,290 (41.7%)	18,165 (52.5%)	992 (7.9%)	10,541 (48.5%)	592 (16.0%)
General Subsidies	25,858	11,669	5,989	6,800	1,400
Target Donations	16,462	4,750	5,574	4,426	1,713
Outcome	75,747	36,211	12,664	23,084	3,787
Current Expenditures	62,215	28,667	11,719	19,142	2,687
Capital Investments	13,532	7,544	945	3,943	1,100
Income - Outcome	-3,137	-1,627	-110	-1,318	-83
Deficit of incomes	4.32%	4.70%	0.87%	6.06%	2.24%

Source: Ministry of Finance. For 2000, PLN in millions.

The highest deficit rate (6.06 percent) was observed in cities with county rights. Communities (municipalities) were second highest. The lowest rates were observed in counties and in regions. This was caused by inexperience since these levels of local government had only been created on January 1, 1999). The data above also show the power of different levels of local governments to collect their public revenues (ratio: public revenues/total incomes). The highest revenues ratios are found in communities/municipalities (52.5 percent) and cities with county rights (48.5 percent). The lowest ratios were observed in counties and regions.

Capital investment expenditures of local governments are very diversified by regions and by level of local government. In Poland, there are 16 regions. They are listed in the following table. In the second column, we listed population for each region. In the following four columns, the values of capital investment per capita in different levels of local governments are listed.

Table 4. Capital Investment Expenditures of Local Governments Per Capita in Poland in 2000

Region (capital)	Population	Communities/ Municipalities (PLN)	Counties (PLN)	Cities with County Rights (PLN)	Regions (PLN)
Lower Silesia (Wrocław)	2,975,074	317.5	37.6	442.6	38.2
Kujawsko-Pomorski (Toruń)	2,101,068	210.7	19.9	335.9	12.7
Lubelski (Lublin)	2,233,271	172.7	33.1	243.0	25.5
Lubuski Zielona Góra)	1,023,829	232.4	26.5	474.0	37.0
Łódzki (Łódź)	2,647,783	205.2	33.0	253.5	6.6
Małopolski (Cracow)	3,226,611	201.9	34.1	408.5	27.0
Mazovia (Warsaw)	5,068,677	543.0	25.7	378.1	16.7
Opolski (Opole)	1,086,608	181.6	27.4	407.2	14.3
Podkarpacki (Rzeszów)	2,127,859	218.7	47.9	342.2	16.1
Podlaski (Białystok)	1,222,011	208.5	46.9	293.7	17.3
Pomerania (Gdansk)	2,194,628	247.0	57.3	476.8	24.0
Silesia (Katowice)	4,857,848	187.1	34.4	296.5	71.1
Saint Cross (Kielce)	1,323,719	217.2	51.9	300.1	75.6
Warminsko-Mazurski (Olsztyn)	1,466,248	190.6	41.5	216.2	11.0
Wielkopolski (Poznan)	3,357,541	259.0	28.2	339.5	19.6
West Pomerania (Szczecin)	1,733,446	269.3	37.7	388.8	13.9
TOTAL	38,646,201	277.6	34.8	342.8	28.5

Source: Ministry of Finance

The data presented in the previous table show that communities (municipalities) in two regions have the highest average capital investment expenditures per capita. They are Mazovia (Warsaw) and Lower Silesia (Wroclaw). Other regions have results below the average. The difference in per capita investment between the region with the highest and lowest per capita amounts was PLN 3.14. The lowest per capita capital investment is observed in rural Lubelski, the Opolski and Warminsko-Mazurski regions and heavily industrialized Silesia. Among counties, the highest per capita expenditures are observed in Pomerania (PLN 57.3), Saint Cross (PLN 51.9) and the lowest in Kujawsko-Pomorski (PLN 19.9). The difference between the highest and the lowest regions is PLN 2.88. The discrepancies between cities with county rights throughout regions are not so significant. The highest per capita expenditures are observed in Pomerania (PLN 476.8) and the lowest in neighboring Warminsko-Mazurski Region (PLN 216.2). The difference between the highest and the lowest average expenditures is PLN 2.21.

Major differences were observed in capital investment expenditures of self-governments on the regional level. The highest per capita expenditures were observed in Saint Cross (PLN 75.6) and in Silesia (PLN 71.1). The lowest expenditures were observed in Lódzki Region (only PLN 6.6 per person). Major differences between regions mostly stem from the fact that new regions were created only one year before the beginning of the period analyzed. The data presented show that differences in implementing capital investment among regions within particular groups of local governments are not so significant. However, it is necessary to keep in mind that the analyzed data are the average data. Real differences between communities, counties and cities are higher.

The differences in capital investment expenditures between regions, counties, cities and communities are the final result of changing regional disparities in Poland in the nineties. The process of increasing regional disparities in Poland in the area of capital investment expenditures, employment and income distribution is described in section 3.

3. Regional Policy and Regional Disparities

3.1 REGIONAL POLICY IN POLAND

After the World War II, Poland was relatively highly-centralized country. Before 1990, all administrative units were subordinate to the central government. In 1990, the first self-governmental units were created in the form of communities and municipalities. In 1999, two new levels of self-government were added: counties and regions. The shortage of regional self-governing units before 1990 does not mean that the Polish government did not have regional objectives. The most spectacular process of reducing regional differences was a program of massive industrialization, which developed new industries on basis of county capitals locations. This process took place in the fifties and sixties. As a result, large factories were constructed in nearly all county capitals. In the seventies, this process was continued however, since 1975, the most important focus was placed on new capitals of administrative regions.

Reform of the administrative division in 1975 changed a system of 17 administrative regions and over 300 counties into 49 smaller administrative regions and over 2800 communes. The 1975 shift, allowed local communities to better lobby for investment financing from the central budget in smaller cities. In 1990, self-governing communities and municipalities replaced administrative communes but 49 administrative regions remained.

These regions were fully dependent on the central government. However, in the first part of the nineties, the central government economic policy was mostly focused on economic transformation instead of reducing disparities. The regional policy objectives were obvious victims of such change. In the mid-nineties, awareness of regional issues increased with regard to expanding regional disparities. Large inefficient factories built in the fifties and sixties suffered a lot of problems connected with low competitiveness. The massive process of collapsing of “old” industries began the process of de-industrializing less-developed regions. In the second part of the nineties, general economic development was located in 5-6 large metropolises, which boomed thanks to a massive brain drain process and inflow of foreign capital. The differences between metropolitan cities and rural areas increased significantly.

In the second part of the nineties, public discussion took into consideration two types of administrative reforms which would better enable Poland to run its regional policy. “Model A” provided for the changing of 49 administrative regions into self-governing regions. The regional policy would be done through small regions. “Model B” proposed to come back to counties and larger regions. In the end, model B prevailed. Political forces started auctioning a number of new large regions. The initial number of 12 large regions was finally changed to 16 (like in Germany) as the result of strong lobbying pressures.

Coordination of the Polish regional Policy was located in the following different governmental bodies in the period of 1998-2002:

- Ministry of Economy 1998-2000
- Ministry of Regional Development and Construction Industry 2000
- Ministry of Economy (2001 – present)

From 1997-1998, the strongest legislative effort was directed at the preparation of administrative reform and at listing the competencies and financing sources of new self-government units.

In May 2000, the first important document concerning regional policy was prepared. The Parliament passed the Act on the Principles of Supporting Regional Development. This Act states that regional development support should be aimed at:

1. Development of different areas of the country, improvement of standard-of-living and satisfaction of needs in local communities,
2. Creation of conditions for increasing competitiveness of local governments,
3. Equalization of differences in the level of development of particular areas of the country and equalizing chances of citizens with no regard for place of living, and reducing backwardness of less developed areas and which have less favorable development conditions.

The Act defines also main tasks in the area of running regional policy. According to the Act, the role of supporter is played by the central government and roles of beneficiaries by regional and local governments.

In November 2000, the National Strategy of Regional Development 2001-2006 was prepared. The preparation of this strategy was enforced by requirements of European Integration. The Strategy provided the following objectives:

1. Increase the average level of GNP per capita in relation to the EU average from 38 percent in 1999 to 47 percent by 2006. The regional minimum should amount to 33 percent of the EU average and the regional maximum to 71 percent.
2. Act against excessive increase of regional disparities by reducing unemployment and stimulating potential for competition in less developed areas.
3. Train human capital working in central and regional administration for effective implementation of regional policy, co-financed by the EU.

4. Utilize administrative reform to increase the pace of development. Increase the value of public revenues of local governments and reduce public resources.
5. The strategic objective of the Strategy is to create conditions for increasing the competitiveness of regions, act against marginalization of less-developed regions in order to support long-term economic development, social, economic and territorial cohesion and integration with EU.

The Strategy provided that the main tasks which would fulfill the above objectives should focus on: the development of infrastructure, the restructuring and diversification of regional economic bases, the supporting of human resources development in problem areas, providing cooperation between regions (cross-border, transnational).

It was provided in the Strategy, that the list of areas requiring support would be created in special support programs, which would be adjusted to financial possibilities of the State. The National Strategy will be put into effect in two phases: a pre-accession to EU phase and one after accession to the EU. The Council of Ministers are responsible for the general coordination of the Strategy but the Minister of Economy is responsible for the Strategy implementation. Concurrently, Regional Steering Committees were created to coordinate the implementation particular regional strategies. All regions prepared their regional development strategies, which constitute the base for conducting the regional policy by the State.

The implementation of regional policy described in the Act and National Strategy is in the initial stage. According to the Act, contracts were awarded to regions and in 2001 the first regional projects were started. However, the size of these projects and their financial allocation is still far ahead of regional development needs.

3.2 CHANGES IN REGIONAL DISPARITIES IN THE PERIOD OF 1990(91)-1998

As mentioned in section 3.1, central governments neglected regional policy issues in the first part of nineties to concentrate on current issues of economic transformation. The only equalizing mechanisms were:

- General subsidies mechanism,
- Local government borrowing,
- Capital investment of infrastructure companies,
- State agency donations, preferential loans and grants,
- Moderate foreign aid

The functioning of these mechanisms was generally not included in any concrete and objective framework, which might state the expected final results. In reality, the size in which each local community managed to use the last four mechanisms depended mostly on the entrepreneurship of community mayors and on political connections. An important part of capital investment was affected by business interests. Therefore, the results of the functioning of these mechanisms of capital investment funding are very diversified.

We decided to measure changes in regional disparities in four areas: regional incomes, infrastructure, environment quality and employment. In order to present the changes in regional disparities, we have compared the following categories:

- Total capital investment in 49 regions in zlotys,
- Average monthly wages in 49 regions in zlotys,
- Labor income in 49 regions in zlotys,
- Density of roads per 100 sq. km,
- Stationary phone subscribers per 1000 inhabitants,

- Untreated waste water in hm^3,
- Reduction of air pollutants – particles in percent,
- Reduction of air pollutants – gases in percent,
- Unemployment rate in percent,
- Employment in particular regions in thousands,
- Employees per 1000 inhabitants,

The base for comparisons was a group of 49 administrative regions. These better show regional disparities than the present 16 large regions[8]. This selection of analyzed categories was due to availability of data. This was why we compared regional labor income but not regional GNP. In 1990, the Main Polish Statistic Office counted national income in the Material Product System and only since 1993 has GNP been counted according to SNA standards.

In relation to all specified categories, we counted the following measures:
- Minimum – the lowest value of the given category in regions;
- Maximum – the highest value of the given category in regions;
- Range – the difference between Maximum and Minimum in all regions;
- Mean – the average value of the given category in all regions;
- Median – the value of a middle item when all items are arranged in either ascending or descending order of magnitude amongst regions;
- Standard Deviation – a measure of the extent of variation in the group of items, the measure considers how far from the mean each of the items in a frequency distribution is located;
- Standard Deviation/Mean*100 – as above and in relation to the mean in percentages,
- GINI – value in points equal to the measured area between the diagonal line of equality and the Lorenz curve, divided by the area of the triangle under the line of equality, multiplied by 100;
- Decile ratio – the share of labor income (and other similar categories) received by the richest tenth of the regions divided by the share received by the poorest tenth of the regions.

We consider these measures to be sufficient to judge changes in regional disparities in Poland. Before presenting the results of the functioning of the capital investment mechanisms it is worthwhile to present changes in regional capital investment distribution in years 1990 and 1998. The data are presented below.

Table 5. Capital Investment in Regions of Poland Using Dispersion and Inequality Measures

Measure	1990	1998
Min	72.0	405.7
Max	1509.9	23263.0
Range	1437.9	22857.3
Mean	236.4	2302.3
Median	164.5	1329.3
Standard deviation	244.2	3613.8
SD/mean*100	103.3	157.0

[8] To avoid problems in analyzing regional differences in present 16 large regions, the Main Statistic Office divided Poland into 44 subregions in 2000 what would facilitate planning and conducting reliable regional policy.

GINI	33.4	46.4
Decile ratio	9.0	57.3

Source: Computations based on Main Statistic Office data. The data presented in table 1 are in new zlotys(PLN) and in current prices. Data contain all types of capital investment: public and private.

The data contained in the table show that dispersion in capital investment amongst regions increased, especially demonstrated by the increase of the SD/mean*100 index (53.7 percent). Other inequality measures increased significantly: GINI from 33.4 to 46.4 and decile ratio from 9.0 to 57.3. The data included in the table show that within the period of 1990-1998 regional disparities affecting capital investment expenditures increased significantly in Poland.

3.2.1 Changes in Regional Income Distribution

With regard to the shortage of suitable data (especially regional GNP values) we decided to check disparities in two categories:

1. Average monthly wages in 49 regions in zlotys,
2. Labor income in 49 regions in zlotys.

Both categories were counted in old and new zlotys in current prices, respective to the each year. The results of counting dispersion and inequality measures are presented in Table 6.

Table 6. Average Wages in Regions of Poland

Measure	1990 (old zlotys-thousands)	1998 (new zlotys-thousands)
Min	858.0	983.6
Max	1263.0	1676.5
Range	405.0	692.9
Mean	980.4	1115.0
Median	967.0	1073.1
Standard deviation	71.3	127.0
SD/mean*100	7.3	11.4
GINI	3.3	5.1
Decile ratio	1.3	1.7

Source: as in Table 5. Monthly wages.

The most striking information in Table 6. is the very low dispersion level of average wages among regions both for 1990 and for 1998. In 1990, regional differences were very slight. In 1998, they were larger but still not excessive. It is also very important to stress the very low values of the SD/mean*100 index, the extremely low values of GINI and decile ratio. However, it should be understood that average wages is a statistical category which has been averaged. This may affect inequality levels. The following computations of dispersion and inequality measures for labor income is counted as the multiplier of the average wages and average number of employees and 12 months.

Table 7. Labor Wage Income of Regions in Poland.

Measure	1990	1998
Min	131	1350.9
Max	2472	26312.5
Range	2341	24961.6
Mean	409	4640.3
Median	341	3355.6

Standard deviation	368	4785.1
SD/mean*100	90.0	103.1
GINI	31.0	34.6
Decile ratio	7.2	19.5

Source: as in Table 5. Data in new zlotys, current prices.

The data contained in Table7. show the regional disparities in relation to labor income grew significantly faster than disparities in average wages amongst regions. Index SD/mean*100 was also relatively high and grew by 13.1 percent. The GINI index shows growing disparities, but the result achieved for 1998 (34.6 points) is only 3.6 points higher than in 1990. Despite a relatively smooth increase of the GINI index, marginal differences boomed between 1990 and 1998. The Decile ratio increased from 7.2 to 19.5 – a difference of 170 percent in relation to the initial value. This indicates that labor-income opportunities significantly changed in favour of richer regions.

3.2.2 Changes in Infrastructure

To present changes in infrastructure, we decided to analyze changes in two categories: density of roads in regions of Poland and the number of stationary phone subscribers. Roads and highways are the responsibility of public authorities in contrast to communication, which is a domain of the business sector. The resulting figures with the regional dispersion and inequality measures are presented in tables below.

Table 8. Density of Roads in Regions of Poland

Measure	1991	1998
Min	41.7	42.7
Max	168.4	183.8
Range	126.7	141.1
Mean	77.9	84.5
Median	69.4	77.8
Standard deviation	30.5	33.4
SD/mean*100	39.2	39.6
GINI	18.0	18.4
Decile ratio	3.3	4.3

Source: computations based on Main Statistic Office data. Density of roads is measured in kms per 100 sq.kms.

The data included in Table 8. indicate very slow progress in road system improvement amongst regions, but this progress is faster in better regions (with higher road density). The calculated measures show that disparities are nearly unchanged, however some changes were observed in the decile ratio. Changes in the decile ratio are evidence that improvements in this system are faster in regions with better highway systems.

Table 9. Stationary Phone Subscribers in Regions of Poland Per 1000 Inhabitants

Measure	1990	1998
Min	50.8	137.0
Max	189.0	418.9
Range	138.2	281.9
Mean	77.4	208.9
Median	70.2	196.1
Standard deviation	26.5	50.6
SD/mean*100	34.2	24.2
GINI	15.0	11.3

Decile ratio	2.7	3.1

Source: as in table 8.

The table above shows significant changes in regional disparities in communication amongst regions of Poland. Despite the fact that range and standard deviation increased in absolute values, they decreased in relative terms. The index SD/mean*100 decreased from 34.2 to 24.2. Also, positive changes were observed in GINI index which fell by 3.7 points from 15.0 to 11.3. Decile ratio increased from 2.7 to 3.1. It confirms again, that regions with relatively very good communication improve this sphere faster than regions less equipped with communication infrastructure. The reduction of regional disparities in communication infrastructure was effected by the business sector which had to work according to regulations favorable for rural areas.

The data presented above show that in some elements of infrastructure, disparities are reduced while in others they are slowly growing. It is very important to underline that disparities between rural and urban areas are continuously decreasing. We do not dispose regional data but only data divided into urban/rural areas. For example, within the period 1990-96 the percentage of households with running water increased in urban areas from 95.3 percent to 96.9 percent in urban areas (by 1.6 percent) and from 67.6 percent to 77.8 percent in rural areas (by 10.8 percent). In the same period, the percentage of households using natural gas increased in urban areas from 71.8 percent to 75.4 percent (by 3.6 percent) and from 6.3 percent to 13.1 percent (by 6.8 percent) in rural areas. Similar changes were also observed in the other installations. This shows that regional differences, especially between rural and urban areas are being reduced. The majority of changes in this area were affected by infrastructure companies and financed from service fees.

3.2.3 Changes in Environmental Protection

Massive industrialization and fast development of urbanization caused huge environmental pollution in Poland. After the economic change, serious stress was placed on reduction of the amount of environmental pollution, mostly in relation to water and air pollution. Below we present the dispersion and inequality data of Polish regions in 1991 and 1998. Table 10. contains data on untreated waste water in regions of Poland.

Table 10. Untreated wastewater in regions of Poland

Measure (in hm^3)	1991	1998
Min	3.1	6.7
Max	794.2	646.7
Range	791.1	640.0
Mean	52.6	57.2
Median	18.36	30.6
Standard deviation	127	94.5
SD/mean*100	241.4	165.3
GINI	64.3	49.0
Decile ratio	91.5	96.5

Source: as in Table9.

The presented values of dispersion concerning untreated wastewater show that dispersion decreases. Unfortunately, it is affected through increasing the lowest values (minimum) and (favorably) through decreasing maximum regional value. There is very positive decrease in standard deviation from 127 to 94.5 and a decrease of relative index SD/mean*100 from

241.4 percent in 1991 to 165.3 in 1998. Positive changes are also observed in inequality measures: GINI index decreased from 64.3 to 49 points. Decile ratio slightly increased from 91.5 to 96.5. Such a high decile ratio shows that in Poland there are regions with huge water pollution and regions relatively very clean. In general, the main direction of changes is rather positive. Regional disparities in treatment of wastewater are decreasing in most of measures.

Another factor analyzed was air pollution by particles. It was an especially important problem with regard to the fact that the most heating was (and is) based on burning coal. Poland has developed so called ‘dirty industries’ as well. In Table 11. below, we present the level at which air pollution particles are eliminated. 100 percent reduction of air pollutants is the most favorable.

Table 11. Reduction of Air Pollutants-Particulates in Regions of Poland

Measure (in %)	1991	1998
Min	67.1	74.2
Max	99.0	99.2
Range	31.9	25.0
Mean	89.7	93.3
Median	91.4	96.3
Standard deviation	7.6	6.7
SD/mean*100	8.5	7.2
GINI	4.2	3.5
Decile ratio	1.4	1.3

Source: as in table 9.

The measures counted in Table12. show that reduction of particles polluting air increased in Poland in the period of 1991-1998. It also shows that dispersion and regional disparities decreased. The mean reduction of pollution particles increased from 89.7 percent in 1991 to 93.3 percent in 1998. Median increased, standard deviation decreased. Also, inequality measures decreased: GINI from 4.2 to 3.5 and decile ratio from 1.4 to 1.3. The data included in the table is evidence of slow reduction of regional disparities in this area. Another issue was the pollution of air by gases. The data on the dispersion and inequality are presented in table 12.

Table 12. Reduction of Air Pollutants - Gases in Regions of Poland

Measure	1991	1998
Min	0.1	0.2
Max	84.2	83.7
Range	84.1	83.5
Mean	9.9	14.0
Median	1.0	5.3
Standard deviation	18.9	19.7
SD/mean*100	189.6	141.1
GINI	72.7	30.2
Decile ratio	531.0	418.5

Source; as in Table 11. Only industry gases are considered.

According to the data on reduction of gas pollution, the situation in this area is significantly different than reduction of pollution particles. The mean value increased within the period of 1991-1998 from 9.9 percent to 14.0 percent but this is relatively low. This means that the rest of polluting gases (in 1998, 86 percent) escaped into the atmosphere. Despite the fact that improvement in this area is not satisfactory – regional disparities decreased in the analyzed period. Despite the fact that minimum and maximum values did not change significantly, relation of standard deviation into mean decreased from 189.6 percent to 141.1 percent. Also, inequality measures decreased their values: GINI from 72.7 points in 1991 to 30.2 points in 1998. Decile ratio decreased from 531 to 418.5. These results are evidence of slow reducing regional disparities in emission of gases polluting air.

3.2.4 Changes in Employment

Equalizing employment opportunities is one of the most important principles of the present Polish regional policy. New employment is strictly connected with improvement of business conditions and general economic situation of the country. The unemployment rate in Poland was 6.9 percent in 1990, 10.4 percent in 1998 and 17.4 percent in December 2001. This problem is significantly sharper now than in 1998. Analyzing the employment changes amongst regions, we took into consideration three categories:

1. Unemployment rate in percent,
2. Employment in particular regions in thousands,
3. Employees per 1000 inhabitants.

Table 13. Unemployment Rate in Regions of Poland

Measure(in %)	1990	1998
Min	2.1	2.6
Max	11.5	20.5
Range	9.4	17.9
Mean	7.0	12.0
Median	7.3	11.8
Standard deviation	2.1	4.1
SD/mean	29.9	34.5
GINI	16.0	18.2
Decile ratio	3.1	7.9

Source: as in Table9.

According to data contained in Table 13, it is possible to admit that both dispersion and inequality measures in Polish regions are growing in relation to unemployment rate. This is especially apparent in standard deviation, which grew from 2.1 to 4.1 in the period of 1990-1998. Also, range doubled and maximum value rose from 11.5 percent to 20.5 percent. The minimum value increased slightly and in result the decile ratio grew from 3.1 to 7.9 in the period of 1991-1998. Also GINI index increased from 16.0 to 18.2. The growth of the decile ratio informs us about increases of marginal values of the unemployment rate. It is important to stress that when the unemployment rate increases, it grows faster in regions with the worst (highest) decile ratios. The change in the regions with relatively small unemployment is relatively small. The following table shows dispersion and inequality of employment in 1990 and in 1998.

Table 14. Employment in Regions of Poland

Measure	1990	1998
Min	116.4	106.3
Max	1631.2	1493.6
Range	1514.8	1387.3
Mean	336.2	324.9
Median	251.2	260.6
Standard deviation	251.2	254.2

SD/mean	74.7	78.2
GINI	28.4	29.6
Decile ratio	5.9	14.1

Source: as in Table9.

The data included in Table 14 show decreases in minimum, maximum and range values. The mean also decreased. Median increased slightly and standard deviation remained nearly unchanged. Inequality measures observed are interesting to note here. The GINI ratio nearly remained unchanged (growing slightly from 28.4 to 29.6 points) but the decile ratio increased significantly from 5.9 in 1990 to 14.1 in 1998. The analysis of data leads to the following conclusion: general dispersion structure of employment in Polish regions remained nearly unchanged, but with regard for the general decline of employment in Poland, the regions which had low employment suffered most and changes only slightly touched regions with high employment. As a result the decile ratio increased significantly.

The last category analyzed was an index of employment per 1000 inhabitants. This index presents labor opportunities in different regions in relative terms. A part of the value of this index is explained by the willingness of labor force to accept jobs, which are offered on the labor market. The dispersion and inequality measures are presented in Table 15.

Table 15. Employees Per 1000 Inhabitants in Regions of Poland

Measure	1990	1999
Min	369	317.2
Max	506	540.4
Range	137	223.2
Mean	435.0	409.0
Median	437.0	420.7
Standard deviation	31.5	47.5
SD/mean*100	7.2	11.6
GINI	3.8	6.1
Decile ratio	1.3	1.7

Source: as in Table9.

Counting dispersion and inequality measures indicates that regional disparities of labour opportunities increased significantly within the period of 1990-1998. Minimum value decreased and maximum value increased. Range increased from 137 to 223. Mean and median decreased with regard for the general decline in employment. Standard deviation increased and the index SD/mean*100 also increased. As a result the GINI index grew from 3.1 to 6.1 and the decile ratio increased from 1.3 to 1.7. The data included in the table confirms the significant growth of regional disparities amongst Polish regions in relation to employment.

3.3 CONCLUSIONS ON THE REGIONAL POLICY AND CHANGES IN REGIONAL DISPARITIES

According to the presented analysis of regional policy and regional disparities it is possible to set up the following conclusions:

1. Distribution of capital investment amongst Polish regions was done in a way, which increased disparities and inequality amongst regions.
2. In infrastructure, positive changes were observed in areas which were under the auspices of local governments and commercial companies: water supply, water treatment,

communication – in these areas regional disparities were reduced. In road infrastructure which was under the prevailing responsibility of state authorities – disparities increased.
3. Positive changes were observed in reducing pollution – regional disparities decreased. This was mostly due to the reduction of dirty production and environmental investment of companies.
4. Significant growth of regional disparities was observed in labor incomes and employment. Weak regions became weaker in both fields, which increased their social problems. The position of the strongest regions became stronger (wages) or remained unchanged (employment). As a result economic disparities among Polish regions increased.

Surprisingly, despite the general reduction of regional disparities in infrastructure, economic disparities amongst regions significantly increased. Probably, improvement of infrastructure was too weak a factor to attract commercial investment, business and employment to rural and less developed areas. The state and businesses became even more centralized (the government liquidated 7 out of 9 large regional commercial banks), the headquarters of numerous important companies were moved to the capital. Only 4 regional capitals headquarter significant financial institutions (Cracow, Katowice, Wroclaw, Warsaw). Through the process of mergers and acquisitions the government moved headquarters of regional banks from: Szczecin, Gdansk, Lublin and Poznan. Two of the four mentioned regional capitals were located in problem regions.

The concentration of wealth in large metropolitan areas creates problems for provincial and rural areas, as well as for metropolitan areas (mass transportation and traffic). The creation of 16 large regions joined in one metropolis unit, averaged out developed areas with rural and less developed areas. The present regions do not constitute homogenous territories with prevailing similarities but differences. This makes regional policy, especially equalizing or reducing disparities, more difficult. It is necessary to conduct sub-regional policy within regions. To catch similarities and avoid differences, the Main Statistic Office created a new category: 44 sub-regions, and though this unit has only a statistic character, it may be used for conducting policy aimed at reducing regional disparities.

Equalizing mechanisms in capital investment funding in Poland allowed significant improvement of infrastructure in rural and less developed areas but sector policy of all governments in the nineties, and close relations between business and politics on the central levels, facilitated centralization of the economy, labor market and incomes.

4. Mechanisms for Financing of Capital Investment for Local and Regional Development

In Section 4, we present the important capital investment funding mechanisms used in Poland. These mechanisms include:
1. General subsidies and appropriated allocations for local governments;
2. Local governments' public revenues and share of central taxation;
3. Local government borrowing;
4. State budget donations for sector purposes;
5. State agencies donations, loans and grants;
6. Regional Contracts;
7. Capital investment financed through service fees;
8. European Union programs.

Apart from descriptions of particular funding mechanisms, the chapter also assesses the compatibility of different funding mechanisms with the present four key principles of operating Structural Funds. These principles included:

- Concentration - focus on main priorities.
- Programming - operating on a basis of integrated programs to ensure better coordination of measures.
- Partnership - linked with the following principle, focusing on inclusion of different partners in cooperation: European authorities, Member State, sub-national authorities and a broad spectrum of economic and social partners.
- Supplementary financial relations – the co-financing of projects by program partners.

Besides these, we decided also to assess the principle of transparency. We understand the transparency principle as using clear procedures, providing honest treatment and public openness of funds appropriation.

4.1 GENERAL SUBSIDIES AND APPROPRIATED ALLOCATIONS FOR LOCAL GOVERNMENTS

There are two main forms of transferring central budgetary sources to local and regional governments. The first one is constituted of general subsidies, which are provided to all levels of local and regional government. The second form is constituted of appropriated allocations.

Using General Subsidies for Financing Capital Investment

General subsidies are direct transfers from the central budget to communities, counties and regions. General subsidies are considered additional revenue to local government public revenues, and can be used for all public tasks (competencies of self governments)[9]. In communities, general subsidies are counted separately for three separate parts: fundamental, educational and compensational. The fundamental part of general subsidies for communities contains an equalization mechanism for diversified tax power of different communities. Thereby, fiscally weaker communities are supported. In counties and regions, general subsidies consist of 3 parts: educational, highways and equalization[10]. Different percentage formulas are used for counting general subsidies for each kind of unit, but the most important factor is the number of citizens living in each unit. To summarize:

1. Each community receives a general subsidy consisting of three independently counted parts: fundamental, educational and compensating.
2. The fundamental part of the general subsidy for communities is counted as 1 percent of total planned incomes of the central budget.
3. Four percent is subtracted from the total sum of general subsidies as central reserve.
4. Each community with tax incomes less than 85 percent of the average tax incomes per person in the nation receives 90 percent of difference between per capita amounts (given and the average).

[9] In this chapter we present regulations for 2000, because we have data form this year. Unfortunately methods of counting general subventions are changing very often.

[10] The fundamental and educational parts of general subsidies are subordinated to real budgetary incomes. Because central budgetary incomes are fluctuating, it is necessary to change local budgets many times in the fiscal year.

5. The remaining amount is divided among all communities relative to the number of citizens and amount of the sum remaining.
6. The educational part of the general subsidy is established as 12.8 percent of the total planned central budget income and divided according to the rules established by the Minister of Education. These rules are based on complicated formulas, including such positions as the number of students and previous expenditures.
7. Similar equalization rules exist for counties and regions.
8. Equalization in counties and regions is put into effect with the equalizing part of general subsidies.
9. The objective of the compensation part of the general subsidy is to compensate for the liquidation of the transport tax on personal cars (former public revenue of communities)

Despite the fact that the value of general subsidy is created using three different mechanisms, there is no specific provision for use of transferred money. Local governments are obliged to fulfill all their tasks (as laid out in the particular self-governance acts for each local government level). However, it is not decided what part of general subsidies should be spent on current expenditures and what part on capital investment. Below we present the mechanism with which general subsidies are used for financing capital investment.

As mentioned in the first paragraph, general subsidies are considered supplemental to public revenues and the other financial inflows, which could be used for financing current activities and capital investment. The procedure of using general subsidies for capital investment is the following:

1. The first step is to estimate all financial obligations of local government connected with current activities (e.g., running public schools, children day cares, local transportation, highways maintenance etc.);
2. The second step is to estimate all obligations connected with the necessary financing of ongoing capital investments as the first priority with capital investment needs for the following year as the second priority;
3. The next step is the creation of a local government income forecast including: general subsidies, allocations, public revenues, allocations and donations from funds, loans and the other resources;
4. The final step is balancing planned expenditures and planned incomes. This shows surplus or deficit. In the latter case, the local government is obliged either to cut expenditures or to indicate additional sources of financing (e.g., taking loans or issuance of municipal bonds).

In fact, the whole procedure is very complicated. In 2000, the Gdynia Municipality had to change the annual budget for 2000 twelve times, of which seven times with regard for changes in the central budget incomes. The last change was executed in December 2000. Similar situations occurred in other local governments.

In 2000, general subsidies accounted for 35.6 percent of the total budgetary income of local governments and amounted to 25.858 million Polish Zlotys (PLN). According to our estimations, they financed 27.61 percent of total capital investment expenditures, which, including local budgets, amounted to 3.735 million PLN.

On principle, the local governments have freedom in spending resources coming from general subsidies after fulfilling obligations connected with current activities. The incomes from general subsidies are matched with the other incomes and they all can be used for capital investment. Investment expenditures of local governments should be included in local budgets. In most of the local governments, special capital investment plans are prepared (but it is not obligatory). Budget information is freely presented and available to all interested.

Spending is governed by the Public Procurement Act of 1995, which imposes the use of rules of transparent and honest procedures. Participants in the procurement procedures are allowed to lodge complaints.

Below there are data presented on the size of general subsidies for Polish local governments in 2000. These subsidies constituted 35.6 percent of all incomes of local governments (which amounted to 72.609 million PLN).

Table 16. General Subsidies of Local and Regional Governments in Millions of PLN for 2000

Part of Subsidy	Total	To Communities	To Counties	To Cities with county rights	To Regions
Fundamental	1.771	1.765	-	6	-
Educational	19.367	8.676	4.689	5.578	424
Compensating	1.743	1.228	-	515	-
Highways	2.316	-	966	602	748
Equalizing	661	-	333	100	228
Total	25.858	11.669	5.988	6.801	1.400

Source: Ministry of Finance (PLN in Millions)

Summing up, the mechanisms used in calculating general subsidies allow for equalizing the differentiated tax bases of different local governments in Poland. It is important that 2.432 million PLN were used in different forms to equalize local development conditions.

General subsidies, as a capital investment funding mechanism, generally meet the criteria of compliance with EU standards. Local governments decide what their main priorities (concentration) are, include capital expenditures in investment plans (programming) and try to apply partnership and supplementary financial relations principle (mostly through matching funds with the other partners). The procedures of using general subsidies for capital investment are also transparent.

Allocations for Capital Investment

Appropriated allocations are aimed at financing concrete tasks, which are listed in the Acts of Incomes of Local Governments (for 1999-2000, 2001). These Acts list two categories of appropriated allocations:

1) Allocations due to each local government (targeted at tasks of governmental administration contracted to local governments and other central government tasks provided by legislation.)

2) Allocations potentially available for local governments; these include:

- Allocations for subsidizing public works of local governments;
- Allocations for eliminating dangers of security and public order;
- Allocations from public target funds;
- Allocations for tasks agreed upon with governmental or other levels administration;
- Allocations for social assistance and housing aid;
- Allocations for capital investment connected with public works of local governments[11].

In general, there are no complaints about the first group of appropriated allocations. When local governments are contracted to perform tasks of central administration, they have to

[11] Gilowska Zyta: *Sources of Financing Local Governments in Poland*, Warsaw 1999, p. 10 (in Polish). This also a functional division of capital investment allocations granted by the central government to local governments. Allocations form target public funds are described in the chapter 3.5.

receive suitable compensation for this performance. In some cases, local governments can overtake some central governmental tasks in return for donations for this purpose (tasks agreed). Also, social assistance allocations and housing aid do not create too many problems (unfortunately, they do not cover all expenditures and the central coverage ratio is scaling down).

Greater difficulty exists with the problem of allocations from public funds. All public funds have very detailed criteria of distributing allocations (as described in section 3.4.). Serious doubts appear when central government allocations are used for capital investments, which are considered public tasks of local governments. The criteria included in the Act of Incomes of Local Governments provide that:

- Allocation may not exceed 50 percent of the total cost of capital investment (80 percent in education and 75 percent in high unemployment units) and,
- Unused allocations should be returned.

Unfortunately, apart from apportionment criteria, there are no provisions for eligibility, maximum size of allocations, application procedures, selection criteria etc. This means that criteria are discretionary and strongly depend on political decisions. Some authors[12] maintain that allocations that finance public tasks of local governments require political decisions. In this context such allocation could be considered an award for electoral support. The only positive side of such target donations is the fact that they cannot be used for other purposes.

Table 17. Target Allocations for Local Governments in Poland in 2000

Item	Total Local Governments	Communities/ Municipalities	Counties	Cities with County Rights	Regions
Allocations for tasks of governmental administration performed by LG (Amount for capital investment)	8,839 (348)	2,501 (34)	3,071 (43)	2,912 (22)	354 (250)
Allocations for public works of LG (Amount for capital investment)	5,928 (1,825)	1,530 (483)	1,982 (449)	1,286 (352)	1,129 (541)
Allocations for tasks agreed with governmental administration (Amount for capital investment)	759 (111)	120 (85)	432 (0)	158 (0)	49 (26)
Allocations for tasks agreed between Local Governments (Amount for capital investment)	678 (246)	417 (53)	57 (15)	40 (29)	165 (149)
Allocations from Public Funds (Amount for capital investment)	258 (187)	182 (132)	33 (22)	30 (21)	16 (12)
Total allocations (Amount for capital investment)	16,462 (2,717)	4,750 (787)	5,573 (529)	4,426 (424)	1,712 (978)

Source: Ministry of Finance (PLN in Millions)

According to the presented data the total amount of appropriated allocations was equal to 16,462M PLN and total capital investment executed from these donations was about 2,717M PLN which constituted about 16.5 percent of the total value of donations. Appropriated allocations financed 20.1 percent of capital investment of local governments in 2000. The highest rate of capital investment in total allocations was 57.1 percent (observed in regions) and the lowest was less than 10 percent (in counties and cities with county law). The highest rate of capital investment was observed in allocations for public works of local governments (which was considered discretionary).

[12] E.g. Zyta Gilowska.

Allocations for capital investment only partly meet EU standards. Especially difficult were allocations for capital investment connected with public works of local governments. The selection of beneficiaries in local governments seems not to be transparent. The criteria of including investment expenditures of the given local government in the central budget are discretionary and based on political decisions. These criteria are not known. All other types of allocations generally meet EU standards.

It is important to underscore that the central government can also appropriate allocations for sectorial purposes. Most of them are distributed on the principle of reducing social costs of economic reforms within the framework of special governmental programs of restructuring mining, steel industry etc. These allocations are only used in small measure by local governments (3.4 percent of total sector allocations for capital investment). This issue is addressed in section 4.3)

4.2 LOCAL GOVERNMENT PUBLIC REVENUES AND SHARES IN CENTRAL TAXATION

Rules of Collecting Local and Regional Revenues

Local taxes, like other taxes in Poland are collected by state tax offices. The tax office has fourteen days to transfer the amount of local taxes due to the Municipality bank account, starting from the day the taxes were paid. Local Authorities (Chairmen of the Board) are authorized to request the quarterly report on the tax revenues, to find out if the taxes were transferred properly. In case of delay, local authorities should be compensated with "penalty interest," similar to that applied to delinquent taxpayers. In the case of legacy and gift taxes, revenues are also collected by tax offices and later transferred to municipality where the property is located. If legacy includes property located in different municipalities, revenues are transferred to municipality of the heir or benefactor. Similar solutions apply to gifts.

Shares in national taxes are transferred from the tax offices to the central budget, and later to local governments. Those transfers should be completed by the tenth day of the month following, that month in which the income taxes were paid. The amount due to municipality is set up on the basis of two indicators: 0.276 (27.6 percent share in national taxes) and the indicator of the compensated share of all municipal units' revenues from national taxes. This allows for scaling down disparities in tax revenues. This indicator is determined as follows:

1. The total amount of PIT revenues in a given region in the previous year is multiplied by 0.276 and by the percentage of the municipality/community inhabitants into the number of the regional inhabitants on June 30th of the previous year;
2. Total PIT revenues in the previous year is multiplied by 0.276 and later by the indicator showing the total amount of the share of PIT paid by municipality inhabitants;
3. The difference of point 1 and point 2 is multiplied by 0.75;
4. The amount of point 2 is later compensated by the amount determined in point 3;
5. The quotient of point 4 and total amount of municipality share in PIT revenues is finally calculated.

Shares in Corporate income tax are not calculated that way. Municipalities obtain 5 percent of the CIT from the companies located in their territory. However, not only location of the head office is considered but also location of all plants. If parts of a plant are located in different municipalities part of CIT also goes to these municipalities. The share for each municipality is based on the share of employees in a given plant relative to the total number of company employees.

Stamp duty fees are collected by designated point, and later transferred directly to the bank account of the municipality. Administrative fees are paid in cash, or by bank transfers directly to municipalities or communities.

Criteria and Procedures

Public revenues remain the main source of capital investment, covering 32.65 percent of its costs. Local self-government units can spend public revenues and shares in national taxes according to the budget plan, which has the form of the local law. The Law on Public Finances, dated November 26, 1998, details the procedures for budget construction. A project of the regional/local budget should be prepared by the unit board and sent to the Regional Accounting Chamber for review, which supervises finances of regional/local authorities until November 15 of each year. The Review of the Chamber is presented to the local council, which accepts the budget in the form of a resolution. The whole procedure of passing the Budget Resolution should be completed by the end of the year or, in some special cases, no later than the end of March the following year. The Local/regional council (Rada or Sejmik) has limited possibilities to implement the changes. It cannot introduce changes, which decrease revenues or increase expenses without acceptance of the local government Board.

Budget Resolution precise incomes are separated into main sources and expenses, which are designated into groups of expenses, (e.g., transportation, communal services, housing, health care, social assistance, public safety and others). This does not include short-term investment expenses included in a given group of expenses. The precise budget also includes long-term investment programs, with specifics of all planned programs. Supplements to Budget Resolution should describe the name of the investment program, its objectives and works which would be financed from the budget, the name of the administrative unit responsible for the program, the time schedule and total cost of the program, the cost of the program for the next two years. Budget resolutions in following years should include financial resources in the amount necessary for its complete and timely execution. An investment program can be reduced or postponed by resolution of the local/regional parliament.

According to Polish law, investment spending, like all other spending should be made efficiently, achieving the best results relative to expenditures, in a way which allows for timely completion of the investment program and fulfillment of the obligations.[13] The last statement is especially important for companies, involved in investment programs with local authorities. According to the law, an investment program should not be started without ensuring financial resources for its execution. However, in practice this obligation is not always met.

Investment expenditures should be made on the basis of the Law of public procurement. According to the last amendments to the Law, only relatively low expenditures, up to 3000 EUR, are excluded from the tender procedures. Companies executing larger investment contracts should be selected in open tenders. If the investment contracts do not exceed 30,000 EUR, a contractor can be selected in a 'limited tender,' where only a select number of organizations are invited. This procedure can also be applied, if the specific character of investment is limits the potential number of companies, which can accomplish it. If the open tender procedure does not select an executing company, a special, two-phase tender can be organized. During the first phase, companies can provide an offer without price.

[13] Law on public finances, Nov.26, 1998 with further changes, § 27 p.3 , 2001.

During the second phase, negotiations are conducted with a limited number of companies. In cases where the tender is canceled due to the lack of sufficient number of offers or if there is an urgent request for contracting goods or services, a tender procedure can be replaced with negotiations, ensuring competitive conditions.[14] Committees, composed of the representatives of the local administration, select offers of companies interested in participating in the public procurement process. In many cases, lack of experience of its members creates the problems with selection of the most appropriate offer, thus leading to lower effectiveness of public spending on investment on the local and regional level.

Fixed and Flexible Expenditures

Local and regional budgets should reflect their functions first and should include the sources for covering the costs of designated works. In the case of the municipality/community, the list of works includes:

- Social assistance including care for disabled and poor persons, assistance to homeless;
- Primary healthcare services, medical care to elderly persons, medical care during maternity;
- Land management and planning;
- Elementary education;
- Local public transportation, maintenance of municipality roads, bridges and squares;
- Water mains, sewage systems, electricity and heat supply;
- Housing;
- Support to local culture and sport;
- Public safety, functioning of the local guards, voluntary fire departments;
- Public markets;
- Maintenance of municipal buildings and public facilities.

Generally a municipality is responsible for responding to basic needs of the citizens.

Counties are responsible for the works, which cannot be efficiently fulfilled by municipality or community due to their complexity or costs. They are responsible for:

- The functioning of the Family Assistance Centers, Social Care Houses;
- Maintenance of county roads;
- Construction supervision, land and building register, water management, environmental protection issues;
- High school education, running of the orphanages;
- Support to disabled persons;
- In public safety, maintenance of police and fire stations;
- Support to cultural institutions, with activities focused on larger are than municipality. Maintenance of historical monuments;
- Functioning of the public health care institutions financed by Health Funds;
- Protection of wild life;
- Functioning of the labor market and assistance to unemployed;
- Protection of the consumers rights;
- Maintenance of county public facilities.

[14] Law on public procurement with changes dated June 22nd, 2001, Dz.Ust nr 76, 2001.

Regions are responsible for regional economic development, and thus include expenditures for elaboration of the regional development strategy, development of the regional infrastructure, investment promotion and support to businesses.

Fulfillment of these designated works and development of community well-being beyond the covering of current expenses, require investment programs. Some of the municipalities and counties have elaborated local development strategies, which show the directions of local development. Tourism requires investments in sewage treatment system, development of local infrastructure, necessary for building, construction of the public baths, pools…etc. Focus on the food-processing industry requires investment in infrastructure, development of agriculture commodity exchange, water sewage system…etc. Elaboration of a local development strategy is not required by the Law, however it is very useful for planning further investment.

Local/regional authorities are independent in their budgetary decisions and the part of revenues spent on investment is at their discretion to decide. Since the municipality budgets in Poland vary between less than USD 100,000 and USD 400 million, the amount, which can be spent on investment depends also on the size of the budget. Larger municipalities also have long-term investment programs (e.g., Poznan, which reserved nearly 50 million dollars for long-term investment programs. Small municipalities, with poor population spend only a few percent of the budget on investment and do not plan long-term investment programs. In every case, the local council makes a decision on the basis of materials elaborated by the unit board.

Main Problems in Implementing Capital Investment

The main problems in implementing capital investment from local governments incomes are low revenues compared to the needs. Local authorities are obliged to cover current expenses, related to the works designated and described above, especially salaries and other personal costs. During the first six months of the current year (2001), salaries and related social tax costs amounted to 51.1 percent of all current costs in municipal budgets. The cost of salaries amounted also to 79.9 percent of municipal public revenues in first half of 2001.[15] After covering current expenses, local governments are free to decide, what kind of investment would be included into the budget.

Besides the lack of sufficient funds, after covering current expenses, some problems are created by the lack of development strategies and long-term investment programs. Strategies generally include and overall vision of the municipality, county or region in the perspective of 10-20 years. Elaboration of the strategy is not compulsory for municipalities and counties[16] and is related to significant costs (USD 10,000 and up). Therefore, it is only part of the local governments' elaborated development strategies. Municipalities have also limited knowledge of how to prepare long-term (4-6 years) investment programs, which should include identification of investment needs and a list of investment priorities with estimated costs. A lack of development strategies and investment programs for all local government units, results in lower interest in capital investment and in lower effectiveness of investments.

We can say that local/regional governments use the EU Structural Funds principles to some extent. Their legal duties and the situation of the particular community/municipality or region determine their criteria, procedures and decisions for investment spending. The whole process is more transparent and conforms to programming and partnership principles, when a regional strategy exists. As we stated above, this is not obligatory for the local authority.

[15] Finanse Samorządów. Ministry of Finance www.mofnet.pl.
[16] It is however compulsory for regions

4.3 LOCAL GOVERNMENT BORROWING

Local government borrowing is considered one of the fastest growing sections of capital investment financing with local governments in Poland. According to our estimations 17.6 percent of total capital investment of local governments was financed through borrowing, amounting to PLN 2,378 million. This amount separates into PLN 1,648 million in bank credits, PLN 503 million in non-bank loans, and PLN 227 million in municipal bonds. These sums were calculated on the basis of the annual increase of bank credits (new credits minus repayments of old credits), non-bank loans (mostly from public target funds) and municipal bonds (new issues minus repayment of old issues). Total debt of local governments in Poland amounted to PLN 9.377 million and was constituted of domestic debt with only PLN 229 million in foreign debt.

The Public Finance Act of 1998 determines borrowing for the local governments in Poland. The Act provides that the deficit of local government budgets should be covered from: sales of securities issued by the local government, bank credits from Polish banks, loans, privatization incomes and surplus from previous years. The Act states that the rate of repayments of credits, loans and other similar sums should not exceed 15 percent of the planned annual incomes of the local government and 12 percent when total public debt is higher than 55 percent of PNB. Another provision of the Public Finance Act provides that the total debt of local government should not exceed 60 percent of the total planned budgetary incomes for the given year. Regional Accounting Offices perform the monitoring over the reality of the budgetary forecasts. Apart from these provisions, there are no obstacles to borrowing for local governments. At the end of 2000, the total debt of local governments constituted 12.9 percent of their incomes. This means that, according to the Act, there is significant potential for further debt. The mentioned rate, however, was diversified according to different units of self-governments. Cities with county rights have an average rate of 17.3 percent, communities/municipalities average 14.8 percent, counties 3 percent, and regions 2.8 percent. Regions and counties have only existed since January 1, 1999 and these low rates are caused by their short period of operation. Regarding cities with county rights, which overtook some works from the national administration, their incomes significantly increased from 1999, and this increased the potential for debt.

Bank Credits

Bank credits are considered a major source of capital investment financing by local governments. The collective data of the Finance Ministry presents the Debt of Local Governments at the end of the fiscal year. The majority of short-term bank loans are not included (they are repaid). This means that long-term debt is dominating. The total amount of bank credits due at the end of 2000 amounted to PLN 4.581 million with 94.7 percent of that, long-term credits. The expenditures financed from long-term debt can be considered 100 percent capital investment. When local governments intend to finance current activities they should repay credits before the end of the fiscal year. Therefore, all long-term bank credits should be considered developmental financing. Furthermore, banks provide long-term credits only on condition that resources are used for long-term purposes – mostly capital investment.

Bank credits for local governments are distributed on a basis of general Banking Law, which requires the creditor to grant a credit on condition that a debtor has the potential to repay a credit and has legal collateral for the credit and the interest. Local governments have various collateral potential. Cities with county rights (joined competencies of community and county) have the highest potential. They possess the most property including: housing, community buildings, community grounds and the other assets. Regions and counties possess the lowest potential. These local government units have the least sellable property, as opposed to communities and cities with county rights.

There are no special legislative limitations (apart from the Public Finance Act and general rules of Banking Law) for spending resources coming from bank credits for capital investment. Expenditures for this purpose are subordinated to the Public Procurement Act, which contains rules for regulating transparent and honest public spending practices. Resources from bank credits are mostly used for improving road infrastructure and the purchase public transportation (buses, trolleys, etc.). Other directions of expenditures backed by bank credits are very rare. The majority of bank credits is received in Polish currency and the basic rule for interest is accepting the market interest of 52-week treasury bonds or the Warsaw inter-bank interest rate (WIBOR). Considering that the interest on 52-week treasury bonds was relatively high in 2000 (15-17 percent) and the same was true for WIBOR, several local governments decided to take domestic credits denominated in foreign currency at Polish banks with rates based on FIBOR or LIBOR. However, credits were only denominated in foreign currencies while they were paid in zlotys. In general, local governments in Poland are very conservative and, unlike businesses, are very reluctant to use foreign currency credits. Unfortunately, there are no data on the size of domestic currency credits denominated into foreign currency (with foreign interest rates).

Non-Bank Loans

Non-bank loans are the second most important borrowing tool used by local governments. Most of these loans come from public target funds (especially from the National Fund for Environmental Protection). Most of these loans have preferential character. The rules and criteria of these loans are described in section 3.5. In 2000, the net increase of non-bank loans for local governments in Poland amounted to PLN 503 million. 98.7 percent of the loans were long-term, showing that they were used for long-term purposes (mostly for direct investment). 99.9 percent of non-bank loans were domestic. The total debt in this form amounted to PLN 2.788 million at the end of 2000.

Because of the fact that the most of non-bank loans had preferential character they were very popular and they were considered a high-priority financing tool. Sometimes granting a donation from the target fund could be subordinated to taking a loan. In the last few years, there is a tendency for public funds to prefer to grant preferential loans instead of target donations. This increases the debt burden on local governments in Poland.

Municipality Bonds

Municipal bonds are considered as the fastest growing method of local government borrowing. However, this form of borrowing is still third (after bank credits and non-bank loans). According to our estimations, in 2000, Municipal bonds financed PLN 227 million of capital investment by local governments in Poland. It constituted about 1.7 percent of the total investment expenditures of local governments. The total debt of local governments in this form of financing amounted to PLN 957 million at the end of 2000. It was approximately 5 times lower than in the case of bank credits and about three times lower than non-bank loan debt. However, these figures can rapidly change by the end of 2001. This is caused by the fact that in 2000 and 2001 numerous local governments reported intentions to issue municipal bonds. According to the Association for the Economic Development of Communities in 1999, there were 53 projects for issuance of municipal bonds amounting to PLN 1,051 million in operation, in 2000 there were 71 projects with amount of PLN 1,182 million and in 2001 there were 113 projects with amount of PLN 1,770 million. About a 70 percent increase in 2 years, creates rapid progress. Below we present data of Association on Municipal Bonds Issuances in 2000.

Table 18. Issue of Municipal bonds in Poland in 2000

Item	Up to 5M	5- 10M	10-100M	Above 100M	Total
Number of issues	33	16	20	2	71
Total value	83.45	101	652.3	344	1180.75
Average value in M	2.53	6.31	32.6	172	13.46
Ratio of number	46.5	22.5	28.2	2.8	100
Ratio of value	7.1	8.6	55.2	29.1	100

Source: Association for the Economic Development of Communities (Values in Millions)

Data included in the table show that the average issue of municipal bonds amounted to about 13M PLN in 2000. Small issuances prevail, however there are some large (in relative terms) issuances. In the second part of 2000 and 2001, local governments announced the following issuances:

City of Bydgoszcz - 159M PLN (08/2000).
City of Nysa - 3.9M PLN (12/2000).
City of Rzeszów - 20M PLN (01/2001).
City of Lublin - 100M PLN (01/2001).
Region of Wielkopolska – 54M PLN (02/2001).
City of Tczew – 15M PLN (03/2001).
Community of Murowana Goslina – 6.6M PLN (03/2001).
Region of Małopolska – 70M PLN (04/2001).
City of Leszno – 30M PLN (04/2001).
Community of Kransobród – 0.3M PLN (06/2001).
City of Szczecin – 60M PLN (07/2001).
City of Szamocin – 7.5M PLN (07/2001).
Region of Podlasie – 30M PLN (07/2001).
City of Piekary Śląskie – 20.55M PLN (08/2001).
County of Świecie – 14M PLN (08/2001).
City of Wałbrzych – 35M PLN (08/2001).
City of Poznan – 105M PLN (08/2001)[17].

The list of municipal bond issuance shows that the majority was issued by cities, especially of cities with county rights. However, it should be noticed that beginning with 2001, new units of self-governments (apart from communities and cities with county rights) appeared on the bond market.

Municipal bonds are considered a very comfortable tool for capital investment financing (mostly for highways, new transportation means, municipal housing development and reconstruction of downtowns). In some cases, municipal bonds assisted in acquisition of preferential loans or even donations from public funds, which required a certain portion of public input by local governments. In this sense, municipal bonds leveraged the potential for raising funds by local governments. The legal possibility to issue municipal bonds was

[17] The specification is based on the press coverage of "Rzeczpospolita" – a quasi official governmental newspaper

created by the Bond Act (1995), which allowed local governments to issue bonds[18]. The Act allowed for closed issuances by local governments with participation of up to 300 purchasers with relatively simplified regulations. Therefore, all issuances (except of Ostrów Wielkopolski) were closed. Only one city decided to issue open market Municipal bonds, which require the acceptance of the Exchange and Securities Commission. However, this was also passed.

Bonds are mostly purchased by banks and insurance companies which carefully check the financial standing of the issuer. Usually, a local government willing to issue bonds looks for issuing agents. In Poland, banks play the role of issuing agents and underwriters of Municipal bonds. Two banks play a key role in this process: PKO BP and PEKAO SA. Other banks are also involved in bond markets as issuing agents, purchasers or issuing underwriters. The municipal bond market is one of the most promising tools to finance capital investment by local governments in Poland. Several Polish cities received rating marks (scoring) for municipal bonds from international rating agencies. It makes issuing bonds easier for them.

Local government borrowing should be considered a financing source for better integration of partnership and supplementary financial relations principles. When a government agency requires public commitment from the local government, borrowing can fulfill this requirement. Criteria, which limit the total amount of debt and debt service costs, reduce the bankruptcy risk (up to now, no local government has gone bankrupt). Also, the transparency principle is used in full: bond issuing agents, and other financial institutions are selected according to the rules of public procurement law.

4.4 STATE BUDGET DONATIONS FOR SECTOR PURPOSES

The state budget donations for sectorial purposes are partly based on the key principles of EU Structural Funds. The most important rule of these donations is to meet state duties to the citizens and to diminish the severity of state reform social costs. The amounts for sectors according to the first principle – concentration – were spent on; converting the regions affected by industrial decline; promoting rural development; modernizing the education system…etc. The governmental sector programs fulfill the second principle – programming – as they are long-term carefully planned programs. However, they do not always fulfill the partnership principle (e.g., restructuring of coal mining and metallurgy programs are not based on partnership). Not all projects that are eligible for state budget donations have to be co-financed from other sources.

The state investment expenditures in specific sectors depend on the government will. Annual state budget law involves the sums for specific tasks. Donations for sector purposes can be formulated in various budget lines: in subsidies for financing of some works, in objective allocations, in subsidies for public company investments, in subventions for regional/local governments. If the minister is the public funds disposer, the minister determines specific rules and procedures of distribution of these funds by decree. The sum for special sector programs can be formulated directly in annual state budget law, (e.g., for coal mining reform or metallurgy restructuring.)

[18] In 2000 this act was changed what generally increased legal opportunities for bonds' issuances.

Table 19. Planned Capital Investment Expenditures of the Central Budget 2000.

Sector	Planned Capital Investment Expenditures in 2000 (PLN in Thousands)
Industry	11,800
Construction	130
Agriculture	111,584
Forestry	2,841
Transport	1,012,221
Communication	63,950
Domestic Trade	938
Miscellaneous Material Services	10,235
Municipal Economy	282,621
Housing Economy and Intangible Municipal Services	1,016
Science	436,080
Education	135,670
Higher Education	394,616
Culture and Art.	55,629
Health Care	1,164,964
Social Welfare	61,972
Physical Education and Sport	58,540
Tourism and Recreation	1,174
Various Activity	13,865
State Administration	304,232
Administration of Justice and Prosecutor's Office	285,999
Public Safety	179,534
Finance	-
Social Security	2,279
Donations for Economic Tasks Financing	-
Various Accounts	2,092,332
National Defense	1,658,525
Offices of Government Administration Bodies, Supervising and Justice Bodies	121,559
TOTAL	8,464,306

Source: Public study based on information from the Finance Ministry

According to the data included in the table above, the most important sectors receiving central budget allocations in 2000 were: transportation (mostly new highways construction), health care (construction of new medical centers and hospitals), national defense (different expenses), education (mostly university level) and science (scientific equipment). The sectorial capital investment expenditures of the Polish government in 2000 (amounting to PLN 5,307 million) and were lower than capital investment expenditures of local governments (PLN 13,532 million) and infrastructure companies (PLN 19,458 million).

The capital investment expenditures in 2000 from the central budget were executed in the amount of PLN 7,428 million (i.e.,, 88.7 percent of the plan after changes and were lower by 0.5 percent than in 1999).

Table 19a. Discipline of Budgetary Expenditure on Capital Investment

Specification	Budget law 2000	Plan after changes	Execution 2000	4:3 (in %)
	(in thousand PLN)			
1	2	3	4	5
Total of which:	8,464,306	8,370,576	7,427,748	88.7
State budget donations	5,022,183	5,787,473	5,307,564	91.7
Regional/local government Donations	1,349,791	2,302,239	2,120,184	92.1
Property reserve	2,092,332	280,864	-	-

Source: Public study based on information from the Finance Ministry

The data included in the table above show that the implementation of capital investment expenditures is not high. 91.7 percent of central budget allocations planned for sectors were spent. From another aspect, state pro-development expenditures in 2000 amounted nine percent of total state expenditures and amounted PLN 13,613,889 thousand.

Table 20. Pro-Development Expenditures of the Polish Budget

Specification:	Execution 1999	Budget Law 2000	Plan After Changes	Execution 2000	5:4	5:2
	(in thousand PLN)				in %	
1	2	3	4	5	6	7
Pro-Development Expenditures Of Which:	13,613,889	12,519,459	14,195,756	13,569,300	95.6	99.6
• Road Construction and Modernization	627,870	690,885	877,670	876,870	99.9	139.7
• Communication Infrastructure	768,722	793,739	906,819	834,083	91.9	105.1
• Export Promotion	25,839	42,748	42,719	42,719	100.0	165.3
• Restructuring Programs. Of Which:	1,490,993	1,826,500	1,776,500	1,612,185	90.8	108.1
Coal Mining	1,451,003	1,786,500	1,736,500	1,575,031	90.7	108.5
Metallurgy	39,990	40,000	40,000	37,155	92.9	92.9

Source: Public study based on information from the Finance Ministry

The pro-development expenditures of the Polish budget are significantly higher than capital investment expenditures of the central budget (they contain the amount of PLN 5,307 million of sector capital investment). This means that significant amounts were used to reduce social costs of the economic transformation (especially in mining and in metallurgy).

4.5 STATE AGENCIES DONATIONS, PREFERENTIAL LOANS AND GRANTS

4.5.1 The National Fund for Environmental Protection and Water Management

The National Fund for Environmental Protection and Water Management (Narodowy Fundusz Ochrony Środowiska i Gospodarki Wodnej)[19] is the largest institution financing environmental protection projects in Poland. The mission of the Fund is to provide financial support for undertakings of a national or interregional scale. The National Fund was established on the basis of an amended Act concerning the shaping and protection of nature which was created on April 27, 1989. It began operating on July 1 that same year. The National Fund's objectives and scope of activities are defined by the following acts:

- The Protection and Shaping of the Environment Act.
- The Water Act.
- The Geological and Mining Act.

[19] Elaborated on the basis http://www.nfosigw.gov.pl.

The projects financed by the National Fund have been described in the “National Environmental Policy” adopted by the Polish Parliament in 1991 and specified in the “Implementation Program for the National Environmental Policy by the year 2000”. The Minister of Environmental Protection, Natural Resources and Forestry supervises their implementation.

Activities of the National Fund are controlled by a Supervisory Board composed of fifteen members, who decide on the direction of the National Fund’s development, approve the terms for granting financial assistance, receive reports on current activities, ratify the budget and ratify financial support for projects exceeding EUR 300,000. The day-to-day operations of the National Fund are coordinated by the Management Board, which represents the Fund, decides on project financing priorities and manages cooperation with regional funds.

The assistance of the National Fund is allocated for pro-environmental undertakings, which are specified in the following priority programs:

- Water pollution control;
- Water management;
- Protection of the atmosphere;
- Land pollution control;
- Forestry;
- Protection of nature and landscape;
- Geology;
- Mining;
- Environmental education.

In particular, priority is given to those undertakings, the implementation of which, will help meet Poland’s commitments towards the European Union with regard to the harmonisation and implementation of European Union law, related to negotiations in the area of “environment” for the Republic of Poland’s membership in the European Union.

The National Fund for Environmental Protection and Water Management (NFOŚiGW) provides the following assistance:

- Loans (may have preferential interest rates in relation to the Bill of Exchange Rediscount Rate (B.E.R.R) determined by the NBP);
- Credits;
- Interest subsidies to preferential credits and loans granted by banks from their public funds;
- Donations.

Criteria for Granting Loans

The interest rates are determined in relation to the bill of exchange re-discount rate (b.e.r.r.) announced by the National Bank of Poland. In the case of a loan granted to the capital city of Warsaw and to Warsaw local communities, the interest rate of 0.5 b.e.r.r. p.a. is applied; in the case of countries the interest rate is 0.2 b.e.r.r p.a.; whereas in cities with county rights it is between 0.1 and 0.5 b.e.r.r. p.a. depending on the total budgetary income per inhabitant. The total income of the country and the municipality/community (generated in the budgetary year preceeding by two years, the year of consideration of the application) is adopted as the total budgetary income. The interest rate is in accordance with the following table:

Table 21. Interest Rate Intervals for Cities with County Rights

Intervals	Percentage of Total Cities with County Rights	Total Budgetary Income Per Inhabitant (in PLN)	Interest Rate (B.E.R.R.) P.A.
I	15	Less than 1,653	0.1
II	40	1,653-1971	0.2
III	35	1,972-2,188	0.35
IV	10	Greater than 2,188	0.5

Source: Data of National Fund

The interest rates on loans granted to municipalities and communities is between 0.1 and 0.45 b.e.r.r. p.a. depending on the total budgetary income per inhabitant (generated in the budgetary year, preceding by two years, the year the application is considered) is adopted as the total budgetary income. The interest rate is in accordance with the table below:

Table 22. Interest Rate Intervals for Communities andMunicipalities

Intervals	Percentage of Total Communities and Municipalities	Total Budgetary Income Per Inhabitant (in PLN)	Interest Rate (b.e.r.r.) p.a.
I	15	Less than 1,007	0.1
II	40	1,007-1,133	0.1
III	25	1,134-1,270	0.2
IV	13	1,271-1,511	0.3
V	7	Greater than 1,511	0.45

Source: Data of National Fund

In the case of particular investments, the interest rate of a loan may be lower and may amount to:

- 0.4 b.e.r.r. p.a. on loans granted for undertakings related to the protection of water and water management, waste management, reclaiming of land, protection of forests and arboriculture, as well as elimination of low emissions;
- 0.5 b.e.r.r. p.a. on loans granted for undertakings related to the equipment and systems of protection against noise, utilization of renewable sources of energy and development of control and measurement apparatus used for the purpose of environmental protection and water management;
- 0.4 – 0.6 b.e.r.r. p.a. on loans granted under credit lines established after 1 January 2001 from the funds of the National Fund;
- 0.6 b.e.r.r. p.a. on loans granted for undertakings aimed at: exchanging technology constituting a hazard for the environment for less harmful alternatives; development of the production of equipment and products used for the purpose of environmental protection and water management; rationalization of the use of energy and water; restriction of the emission of pollutants into the air; prevention of pollution and waste production, including the introduction of clean production and sulphur removal from minerals used to produce energy;
- 0.7 b.e.r.r. p.a. on loans granted for the start-up and development of production of products with lower levels of pollution for the environment.

The interest rates on loans may be lower than those mentioned above, at the request of the entrepreneur.

The subsidy granted in the form of a loan or donations may not exceed 70 percent of the cost of the undertaking, with a possible grace period of up to 12 months calculated from the date of completion of the particular undertaking, specified in the contract, on the date of conclusion of that contract. The period of credit for loans is up to 15 years.

A loan granted from the funds of the National Fund may be partially redeemed at the request of the borrower if: the undertaking has been completed no later than the deadline specified in the contract; the material and environmental effect determined in the contract has been achieved; at least 50 percent of the principal and interest has been repaid within the deadlines specified in the contract; and the borrower has fulfilled the obligation to pay charges, fines and any other liabilities to the National Fund. Moreover, the borrower shall use the redeemed amount of the loan for an environmental undertaking, and the amount redeemed may not exceed 75 percent of the planned costs of the undertaking for which it will be allocated. The redeemed amount shall be up to 15 percent of the amount of the loan granted. Credits of up to PLN 100,000 granted from funds of the National Fund under credit lines shall not be redeemed.

Criteria for Granting Donations (Appropriated Allocations)

Donations may be granted also to budgetary units, hospitals, schools, welfare homes, and other organizational units conducting activities within the field of health protection, prevention, social welfare, education, culture, and protection of monuments and the landscape. The amount of the donation depends on its purpose and on the total budgetary income per inhabitant in the local government unit applying for the donation. It is granted for up to 30 percent of the investment costs of the undertaking.

Award of the donation depends on whether the applicant is fulfilling obligations to pay charges and fees constituting the income of the National Fund, as well as other liabilities specified in contracts. The donation is granted on the basis of an agreement, and does not refer to completed undertakings.

Loans, credits, subsidies to interest and donations from the funds of the National Fund are awarded for purposes specified in the Act of January 31, 1980, On the Protection and Shaping of the Environment (uniform text in Journal of Laws of 1994 No. 49, item 196, as amended) in accordance with the priorities and rules of granting financial assistance from the funds of NFOŚiGW. A procedure for choosing the best projects from all of the available applications submitted to the National Fund was introduced in 1998.

All applications for donation are subject to evaluation from the point of view of completeness, and to environmental/technical as well as financial evaluation. As a result of the evaluation, those undertakings are selected, which are the best prepared and which provide the best environmental effect. A ranked list of undertakings to be subsidized is created, with the best undertakings listed first. The final shape of the agreement is subject to negotiation. If the applicant does not accept the terms of the subsidy, the application is rejected due to the applicant's withdrawal. Decisions concerning the subsidy of particular applications are made by the Management Board of the National Fund in the form of a resolution. If the amount of the subsidy exceeds EUR 1 million in the case of a loan, or EUR 500,000 in the case of a donation, the decision of the Management Board of the National Fund requires the approval of the Supervisory Board. Then, a contract is signed. The commitment of the National Fund to pay out funds is established after the conclusion of the civil-law contract, on terms specified in that contract.

The National Fund controls the way in which, the financial means are spent by the applicants who received them. The implementation of an agreement, signed by an applicant when granted financial assistance, is scrupulously supervised by highly qualified staff. The implementation of the agreement is controlled from both the financial as well as the environmental point of view. Usually, funds for subsequent phases of the investment are transferred only after the previous ones have been accounted for and completed. Every modification of the project timetable or expense plan requires the consent of the Fund's Management Board. In cases where inconsistencies in the implementation of the project have been noticed, the agreement may be revoked and the granted financial resources must be returned to the National Fund. Efficient control mechanisms guarantee that public funds are spent in strict accordance with approved procedures.

Table 23. The Number of Loans and Donations Granted by the National Fund

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	TOTAL
Agreements - total	117	360	630	519	1038	1266	937	576	517	5,960
Loans	43	230	267	157	186	235	234	106	117	1,575
Subsidies	74	130	363	362	852	1031	703	470	400	4,385

Source: Data of National Fund

Table 24. The Amount of Loans and Donations Granted by the National Fund

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Expenditures – total	8,2	116,8	279.3	316.9	472.9	815.0	1,089.3	1,019.9	914.3
Loans	6.2	106.9	239.4	260.7	346.7	647.1	846.3	781.8	709.2
Subsidies*	2.0	9.9	39.9	56.2	126.2	161.9	243.0	238.1	205.1

*excluding supplements for interests on preferential credits and remissions. In Millions PLN
Source: Data of National Fund

Table 25. National Fund Expenditures for Pro-Environmental Projects

Field of activities	1990	1991	1992	1993	1994	1995	1996	1997	1998	TOTAL
Protection of the Atmosphere	2.8	57.4	94.2	149.4	171.2	425.1	395.8	333.9	281.0	1,910.8
Water Protection and Management	4.6	46.7	139.3	109.5	192.6	270.6	445.0	425.6	465.6	2,099.5
Land Pollution Control	0.2	8.7	15.5	19.3	34.5	44.8	52.0	92.5	56.0	323.5
Protection of Nature	0.6	1.2	5.6	9.5	28.3	27.6	31.2	38.4	40.5	182.9
Monitoring	-	1.9	10.9	15.8	16.0	9.7	11.1	9.4	9.6	84.4
Environmental Education	0.1	0.7	2.0	3.8	4.1	9.7	16.8	17.7	15.4	70.3
Environmental Hazards	-	0.1	11.7	9.6	26.2	27.5	42.5	47.2	17.9	182.7

Source: Data of National Fund. In Millions PLN

Expenditures of the National Fund in 1990-1998 for pro-environmental projects according to fields of activities amounted to a total of PLN 5,486.8 million.

The environmental effects of the National Fund's activities created as a result of agreements concluded between 1990-1998:

- Protection of the atmosphere,
- Water pollution control,
- Water management,
- Land pollution control.

The diminishing of regional disparities is not the main priority of the Fund, as it is focused mostly on ecological impact. However, the Fund's activity does lead to equalization of the regional development levels indirectly. Generally, the rules for granting loans, donations/allocations used by the Fund are consistent with EU Structural Funds principles, especially with programming, partnership and supplementary financial relations. The concentration principle is realised by focusing on less developed communities, municipalities or cities when the loan is awarded. Transparency is assured as the ranking list of the “best projects” is created and announced. “The best” means projects, which assure best combination of price and ecological and material effect.

4.5.2 Agency for Restructuring and Modernization of Agriculture

The Agency for Restructuring and Modernisation of Agriculture (ARMA, Agencja Restrukturyzacji i Modernizacji Rolnictwa)[20] is a leading governmental institution in Poland. Its mission is to support measures to accelerate the process of structural transformations in agriculture and rural areas. The Agency was established in 1994 based on the provisions of the Law of December 29, 1993, which together with other legal acts, provide for ARMA’s main activities covering support for:

- investment in agriculture, agri-food processing and services for agriculture;
- measures to create new jobs in the off-farming sector for inhabitants of rural areas;
- development of technical and production infrastructure in rural areas;
- improvement of the agrarian structure;
- investment related to the establishment of commodity exchanges and wholesale markets;
- measures to enhance or change qualifications by rural areas inhabitants, to upgrade agricultural advisory services and agricultural information and to implement and disseminate accountancy in farm holdings.

The Agency is headed by the President appointed by the Prime Minister of the Republic of Poland upon the motion of the Minister of Agriculture and Rural Development and the Minister of Finance. The President’s consultative and advisory body is the Agency Council.

The Agency for Restructuring and Modernisation of Agriculture was established following the model of similar institutions operating in EU member states and it performs its tasks by providing payments that reduce interest rates on credits given by banks, providing credit guarantees and guarantees of repayment of banking loans and credits.

The common feature of all the Agency’s financial assistance (i.e.,, payments to interest rate on investment and working-capital credits provided by banks from their public funds; guarantees and securities of repayment of banking credits; participation in financing investment projects related to technical and production infrastructure in rural areas; co-financing measures to enhance and change professional qualifications of rural inhabitants) is to combine public funds, managed by the Agency, with investor’s own funds. This rule has contributed to effective utilization of public funds and provision of borrowers’ funds.

ARMA’s financial assistance, regardless of its form, provided from the national budget fund is always a supplement to an investor’s own funds as financial resources transferred by the Agency support but do not replace investor’s own funds.

Furthermore, ARMA offers financial aid for measures to create alternative sources of income in rural areas, to enhance or change qualifications and to create new jobs for the rural population without the necessity of changing residence in rural areas. It also provides support for the construction of technical and production infrastructure in rural areas.

In addition to investment projects in agriculture, agri-food processing and services, credits may also be granted for the establishment and organisation of farms by young farmers, for the purchase of agricultural land and for the establishment and organisation of farm holdings under the agricultural settlement program.

[20] Elaborated on the basis of http://www.arimr.gov.pl.

The main form of ARMA's assistance is supplementary coverage of a portion of interest on investment credits to implement projects in agriculture, agri-food processing and services for agriculture. Credits are provided by banks from their own funds in accordance with the banking law in force, based on detailed rules developed by the Agency and accepted by the Ministry of Agriculture and Rural Development. There has been a great interest in preferential credits.

Between 1994 and 2000, banks co-operating with the Agency concluded about 226,000 credit agreements (with Agency's supplementary payments to interest rate) for the total amount of PLN 10,103 million (around EUR 2714 million), out of which 75,000 (33.2 percent) credits were provided from main investment credit lines. 74,000 (32.7 percent) credits were provided for establishment and organisation of farm holdings by people below 40 years of age and 52,700 credits (23.3 percent) for the purchase of agricultural land.

A large group of ARMA's financial assistance recipients are farm holdings, agri-food processing plants, entities rendering services for agriculture and operators interested in creating new jobs in rural areas. In addition, ARMA provides assistance for communities (communes) involved in implementing projects related to technical and production infrastructure in rural areas, universities, schools, agricultural advisory services centres, units involved in education or advisory services for the food sector and operators setting up agricultural commodity exchanges and wholesale markets.

ARMA's financial assistance accelerates structural transformations in agriculture and agri-business by contributing to the improvement of quality and effectiveness of agricultural production, enhancement of its competitiveness on the domestic and foreign markets and supports preparations of Polish agriculture for integration into the EU.

The procedure of applying for a loan usually provides for the development of a business plan of the undertaking, submission of an application for a loan to the Bank cooperating with ARMA, together with the business plan of the undertaking and other documents required by the Bank, and, finally, obtaining a positive review from the Agricultural Advisory Centre (Ośrodek Doradztwa Rolniczego) valid for the place of implementation of the undertaking.

In the case of a guarantee, during the duration period of the guarantee, the entity on whose request the guarantee was granted is obliged to forward periodic statements and reports as well as, documents and information necessary for the assessment of its financial and economic situation to the Agency.

The role and significance of the Agency in supporting undertakings accelerating structural changes in agriculture and in the rural areas, explains why in the last few years the great majority of budgetary grants for investments in agriculture and food economy were and still are transferred to the beneficiaries through the Agency. The scale of the financial aid realised by ARMA can be illustrated by the level of expenditures, which in the previous 4 years (1997-2000) amounted on the year's average to PLN 1,661million, including PLN 1,142 million for the basic activities. Detailed information on ARMA programs and support criteria is included in Appendix 1.

ARMA's rules are based mainly on concentration and supplementary financial relations principles. We can say, that Agency realised all three EU Structural Funds and Priority Objectives for the programming period 2000-06, including promoting the development and structural adjustments of regions, supporting the economic and social conversion of areas facing structural difficulties and supporting adaptation and modernization policies and system of education. The applicants have to prepare a business plan in some cases, which is also an element of the programming principle. The ARMA's activity leads directly to equalisation of the region development levels.

4.5.3. Industrial Development Agency

Industrial Development Agency (IDA, Agencja Rozwoju Przemysłu)[21] plays the role in Polish industry of the restructuring agent, provider of financing, strategic investor, institutional leader, and, on behalf of the State Treasury, the managing entity of the Special Economic Zones. IDA's mission is to actively participate in the process of transformation of enterprises, adjusting them to operation under free market conditions. IDA started its activity on January 25, 1991 as the joint-stock company 100 percent owned by the State Treasurv.

Major IDA activities are:

- Financial restructuring of enterprises – consisting of participation in bank conciliatory and court settlement proceedings. Within these actions IDA supports the restructuring programs by, inter alia reducing part of the debt, prolonging its repayment period, or swapping debt to equity.
- Restructuring support (technical assistance) - IDA participates in the development of restructuring programs for individual enterprises, groups of companies, and industrial sectors. These are mainly financed from the Agency's public or EC PHARE funds.
- Providing financing - the support by lending financial sources to the enterprises is aimed to carry out restructuring and investments activities. It is financed from the IDA's own financial resources or within the EFSAL program.
- Capital investor - IDA, as a result of the debt and investment activity-supporting enterprise restructuring processes, is a shareholder of 114 companies (as of December 31, 2000).
- Regional development activity - One of the functions performed by the IDA through the intermediary of the Regional Development Agencies (RDA), is the development of institutional infrastructure supporting the realisation of state regional policy.
- Special Economic Zones - IDA has been charged with the task of managing EURO-PARK Mielec and Tarnobrzeg EURO-PARK Wislosan Special Economic Zones.
- Post-restructuring assets managing - IDA is the owner of two historical facilities. These are castle-and-park complexes in Krasiczyn and Baranow Sandomierski. The complex in Baranow Sandomierski is used as the representative and hotel facility for the Mielec and Tarnobrzeg zones.
- Training activity - IDA carries out training activity on the process of stimulating economic changes and adjusting the economy to EU requirements. This activity is financed from the Agency's public funds and EC PHARE funds.

Financing Industrial Restructuring

Industrial Development Agency SA fulfils its statutory duties by providing financial support to industrial enterprises undergoing various stages of the restructuring process, including financing preparation of the restructuring programs and business-plans, as well as providing loans for development projects and securing working capital while the company is implementing its restructuring program.

In 1999, the Agency offered financial assistance to three large restructuring programs; those involving tractor works, aircraft and defence industries. For the most part, the Agency financed these restructuring programs with its public equity, as well as with EFSAL funds, resources from the PHARE fund and other international assistance facilities. In a majority of

[21] Elaborated on the basis of http://www.arp.com.pl and *IDA Annual Report 2000.*

cases, financial assistance is addressed to companies, in which the Agency has become a shareholder or stakeholder through debt conversion. These loans help improve the economic and financial situation of the recipients and consequently increase the value of shares/stock of the companies undergoing the restructuring process. The Agency recovers the funds invested earlier by selling its shares and stakes.

In 1999, the Agency loaned 112.4 million zloty and in 2000, 80.5 million zloty from its public funds. In 2000, 39 companies received IDA loans. EFSAL funds available under the World Bank Credit Facility are earmarked for loans and subsidies financing key restructuring projects or alleviating the consequences of closing down various companies. Thus far, 75 companies have received EFSAL loans for a total of 410.3 million zloty. Most of these funds were used to finance restructuring programs of special industries in either a social or economic sense, such as the defence and aircraft industries or tractor works. In 2000, four companies received 14.2 milllion zloty from EFSAL funds. Assistance in the form of loans is distributed in individual industries as follows:

Defense industry	26.5 Million
Metal industry	16.8 Million
Metallurgy	14.0 Million
Food industry	10.0 Million
Tractor industry	8.7 Million
Aviation industry	3.9 Million
Paper industry	3.2 Million
Other (rubber, chemical, furniture, automotive, cereal, textile, tool-making)	11.6 Million

Source: Annual Report 2000, IDA.

Moreover, in 2000, the Agency, in implementing the INITIATIVE program (PHARE funds), granted 22 loans for employees who were laid off under the restructuring process in the metallurgical industry. The value of all financial resources granted in the form of loans constituted PLN 281.7 million at the end of 2000.

The Agency has allocated 117 million zloty for supporting the restructuring processes in selected defense-industry companies. In the future, these loans will be converted into shares/stakes in these companies. In 2000, six defense industry companies have received loans for a total of PLN 26.5 million. Apart of financial support, the Agency serves as a consultant. As a result, IDA has allocated PLN 83.2 million for support of restructuring processes in 2000.

In 1998, the Agency became involved in the restructuring of the aircraft industry companies based in Mielec, financing the development of the restructuring program for Zakład Lotniczy PZL Mielec Sp. z o.o. aircraft factory. The Agency participated in the creation of a new company called Polskie Zakłady Lotnicze Sp. z o.o., established after the bankruptcy of Zakład Lotniczy PZL MIELEC Sp.z o.o. aircraft factory, together with some of Mielec and the former employees, taking over commercial contacts of the bankrupt factory. The Agency provided financial assistance to the new company, including substantial loans and contribution of other assets worth over 20 million zloty. In order to ensure implementation of the contract for the delivery of aircraft to a Venezuelan customer, the Agency issued a joint guarantee for nearly USD 20 million. Under the aviation industry restructuring process, the Agency increased the company capital of Polskie Zakłady Lotnicze Sp. z o.o. (Polish Aviation Plant, a Limited Liability Company) by PLN 23.5 million in 2000.

As part of the restructuring process at ZPC URSUS SA tractor works, the Agency granted loans to four Ursus subsidiaries (based in Sulęcin, Chełmno, Nisko and Włocławek) using its public resources and financing provided by the Labor Fund.

Another form of financial assistance provided by ARP S.A. was sureties. In 2000, the Agency granted credit sureties to five entities for a total amount of PLN 31.6 million.

Since 1997, the Agency has been acting as the Financial Intermediary and Implementing Agency for the Ozone Depleting Substances Phase-Out Project (ODSP) based on an agreement to manage the project signed by Minister of the Economy and IDA SA. The project is implemented on the basis of a grant agreement with "Global Environment Facility Trust Fund" signed between Poland and the International Bank of Reconstruction and Development. The donation of USD 6 million granted to Poland in support of the implementation of the national program concerning the elimination of substances depleting the ozone layer, covered the following enterprises: POLAR Wrocław, ZAMEX Żagań, INŻYNIERIA Warszawa, METALPLAST Oborniki, POLFA Warszawa, Zakład Produkcji Rynkowej Sp. z o.o. Poniatowa and the PROZON Foundation in Warsaw. Under the PROZON subproject, a Centre of Freon Regeneration was established, which was opened in mid-2000.

The Agency has allocated USD 5 million from the Taiwanese loan for support of small and medium enterprises (SME). In January of 1999, IDA signed a loan agreement with The International Commercial Bank of China (ICBC), Taiwan, ROC. So far, 272 companies have taken advantage of loans granted by the Agency from its public resources and from external funds. As of December 31, 1999, the Agency has loaned 351.4 million zloty to finance industrial restructuring. In 2000, the Agency concluded 5 loan agreements totalling PLN 4.5 million.

Financial Enterprise Restructuring

Despite the Agency's approach to repayment rates and interest on its loans, the financial situation of some debtors prevented them from making timely payments. The Agency was forced to restructure their debt, either through banking conciliation proceedings, court-managed composition proceedings, bankruptcy proceedings or bilateral talks. In 1999, the Agency participated in three court-managed conciliation proceedings and 76 bankruptcy proceedings, five of which were resolved. As a result of bilateral talks, the Agency has restructured the debt of 19 companies, forgiving part of their liabilities and converting debt into shares/stakes or taking up other assets. Overall, as a result of financial restructuring of various companies, the Agency has forgiven loans for 19.0 million zloty and converted debt into stock worth 27.0 million zloty. In 2000, under completed bankruptcy proceedings, the Agency redeemed loan-related debts for the amount of PLN 18.4 million. At the same time, by a decision of the Management Board of ARP S.A., debts of 10 entities were converted to stocks or shares for a total amount of 55.1M PLN, whereas loan-related debts worth PLN 17.3 million were converted to other types of assets.

Technical Assistance in Industrial Restructuring

IDA works associated with supporting industrial restructuring consist primarily of technical assistance offered to individual companies, groups of companies or entire industries. This includes:

- participation in developing new projects and financing or redistributing financial resources for restructuring programs;
- assistance in implementing approved restructuring programs;

- supporting the restructuring processes by offering wide-ranging consulting, organizational and training assistance services.

In terms of technical assistance involving projects financed by the European Union assistance funds (i.e.,, PHARE'93 and PHARE'94 funds and "Industrial Development Counterpart Funds" – IDCPF), the Agency cooperates with the Foundation for Industrial Restructuring (FIRE). Total value of the contracts to implement long-term financial projects using PHARE funds (completed in the first half of 1999) reached EUR 27.7 million, of which EUR 24.6 million was actually spent, while the total value of contracts for financial projects with IDCPF reached 0.8 million zloty, out of which 0.6 million zloty has already been paid. Funds allocated for the implementation of tasks to which the financial assistance referred in 2000 came, as in the year before, from foreign financial aid (mainly IDCPF – "Industrial Development Counterpart Funds" and PHARE), a loan from the World Bank, and the Agency's public resources. In 2000, entities, which benefited from the technical assistance provided in various forms by IDA included:

- Ten enterprises from the food processing machine industry;
- Three enterprises from the iron and steel industry;
- Fifteen entities implementing the pia - sf (profitability improvement analysis - success fee) method;
- Eight entities implementing restructuring programs.

As part of its technical assistance provided to companies undergoing restructuring processes, the Agency has participated in the following projects in 1999:

- Continued efforts as part of the Managing Team which coordinated development of industry programs (project financed by PHARE'93 and PHARE'94);
- A study of the Agricultural Processing Machinery Industry;
- Restructuring the Consumption of Fibrous Materials by the Paper Industry;
- Analysis of Essential Pre-conditions to Implement EU Directives on Batteries Containing Hazardous Substances;
- The Agency was a leader in implementing recovery programs with the application of PIA-SF method (Profitability Improvement Analysis-Success Fee);
- The Agency supported the following efforts of the government authorities: Developing Concept of Creation of Trust Security Mining Fund for Laid-off Employees from Closing Hard Coal Mines.

Additionally, the Agency has developed a project called Utilization of Resources Allocated for Faster Closure of KWK NOWA RUDA Coal Mine.

- While participating in the work of the Managing Committee, the Agency helped supervise a project called "Development and Implementation of a Permanent Monitoring System of the Type and Scope of State Assistance in Poland". Pursuant to the Bill on Public Orders, IDA prepared and conducted a bid to implement a project called "Situation on the Market for Home Appliances, Including the Market Shares of Specific Companies and Their Output" (IDCPF financing).
- The Agency offered technical assistance in restructuring Warszawskie Zakłady Telewizyjne Elemis SA, a Warsaw-based maker of TV sets (using its public funds).
- IDA supported restructuring processes in the Polish steel industry. In 1999, just as in the previous years, the Agency, together with the Foundation for Industrial Restructuring (FIRE) was offering consulting and organizational assistance on restructuring Polish steelworks. The project was financed by the PHARE fund.

Criteria of Financing

USD Credits for Investment Undertakings

Credit may be granted to eligible Polish SMEs for buying buildings or building, buying technical equipment and modernisation. Credit may amount to USD 1 million and up to 70 percent of the value of investment outlays. Repayment is within a maximum 5 years, with a possible 2-year grace period in the repayment of capital, the interest rate under negotiation, not higher than 8.5 percent, commission or up to 1.5 percent of granted credit. A guarantee is required.

Financing of Undertakings Related To New Jobs Creation Or Start-Ups by Ex-Workers of Metallurgy (by EU PHARE PL Initiative Funds)

Loans may be granted to eligible legal persons and eligible legal individuals for buying, building or modernization of buildings; buying of equipment, materials or resources, etc. Loan amount for start-ups is a maximum of PLN 60,000, for new jobs creation it ranges up to PLN 35,000 per job. One applicant can obtain one loan up to PLN 210,000. The applicant contribution is required (a minimum 25 percent of the applied for amount). Repayment has a maximum of 4 years, with a possible 1-year grace period in the repayment of capital, an interest rate of 5.5 percent and a commission of 2 percent of the granted loan. A guarantee is required.

IDA is engaged in supporting the economic and social conversion of areas facing structural difficulties (one of the EU Structural Funds Priority Objectives - concentration principle). It covers financial and technical assistance. In this sense, IDA tries to equalize the regional disparities directly.

4.5.4 Polish Agency for Enterprise Development

The Polish Agency for Enterprise Development (Polska Agencja Rozwoju Przedsiębiorczości)[22] is a governmental agency established in the year 2001 as the result of the transformation of the Polish Foundation for Small and Medium Enterprise Promotion and Development which was active in the years 1996-2000 on the basis of the Act on Establishment of the Polish Agency for Enterprise Development from November 9, 2000 (official gazette announcing current legislation from 2000 no.109 pos.1158). The Agency is subordinated to the Minister of the Economy. The objectives of this Agency include implementation of economic development in programs, especially in the areas of development of small and medium-size enterprises (SMEs); exports; social and economic cohesion. The Agency is involved in a number of support programs, and it provides grants for co-financing initiatives that support entrepreneurship development as well as directly supporting entrepreneurs. Activities of the Agency are financed out of the national budget and European Union funds. The Agency cooperates with more than 150 local business-counseling centers, which are grouped in the National SME Service Network (KSU). The above-mentioned counseling centers operate under an accreditation system.

[22] Elaborated on the basis of http://www.parp.gov.pl.

Table 26. Selected Projects Conducted by PARP

Form of Assistance		For Whom	Amount of Assistance	Comments
Donations	For Training	SMES	Up to 60% of the net price of 1 training course, but no more than PLN 1,000 and up to PLN 5,000 annually for 1 entrepreneur	
	For ISO certification	SMES	Max. 60% of net costs of advisory and training services, up to PLN 20,000 for small entrepreneurs and PLN 25,000 for medium-sized entrepreneurs; up to 60%, of net costs of the certification audit, for small entrepreneurs up to PLN 6,000, and for medium-sized entrepreneurs, up to PLN 12,000. For simultaneous planning and implementation of more than one management system, the above-mentioned limits increase by 50%.	
	For the preparation for participation in the capital market	SMES	Max. 60% of those qualified.	
	For increasing the capital of loan funds of guarantee funds for small and medium-size entrepreneurs	Local guarantee funds		
	For information and advisory services	SMES	10 hours of free information and advisory services per 1 SME annually	
	For an initiative supporting the development of entrepreneurship in 2001	Sounds	Up to 50% of documented costs of organisation of the undertaking or share in the undertaking; during one calendar year, max. 3 donations per 1 organisation, up to PLN 150,000.	In 2001, PLN 1.8 million was set aside for donations to initiatives supporting development of entrepreneurship.
	Export Promotion Program	Exporters from SMES sector	Min. EUR 1,500, Max. 60% of costs, up to EUR 10,000.	Program budget EUR 2,750,000.

Source: Our own study based on information from the Polish Agency for Enterprise Development (PARP)

The implementation of the project under the INITIATIVE program (preferential loans for the mining industry) was completed in December 2000. 142 SMEs and 224 eligible persons starting up businesses benefited from the loans. The assistance helped create 577 jobs for former workers from the mining industry. By the end of July 2001, about 27 SMEs and 19 eligible persons starting up businesses used the preferential loans for the metallurgic industry. In this case, 88 jobs for former workers from the metallurgical industry were created.

In fact, the Agency supports many more programs. Unfortunately, there is no public information about the efficiency of specific programs. In addition, the agency has no clear evaluation criteria or any determined cost factors of appropriated assistance. Therefore, it is impossible to monitor assistance costs per consulting hour, the cost of creating one workplace, etc. Despite these shortages, it is necessary to underline that most Agency projects are conducted on a regional basis, in cooperation with local governments and NGOs.

The Agency procedures are consistent with EU Structural Funds principles. The majority of the funds come from the EU itself, so the requirements are those procedures functioning in the EU.

Generally, we observed that money disposed by government agencies goes to those organizations, bodies and individuals, which are better informed than others, are more entrepreneurial and know required procedures well. In practice, some strong regions draw new strong sets and weak regions stay weak.

4.6 REGIONAL CONTRACTS

One relevant element of funding regional investments in Poland is regional development support from the State budget. It takes place on the basis of the Act on Regional Development Support Principles of May 12, 2000, which allows the conclusion of so-called ‘regional contracts’ between the Government and the regional administration.

Under regional contracts, funds from the State budget may be assigned for:

1. Development of entrepreneurship, mainly SMEs, business innovations, transfer of technology;
2. Restructuring of selected sectors of public services and of local and regional economy;
3. The creation of new jobs;
4. Investments in the technical and transport infrastructure, improving the conditions of implementation of business investments;
5. Undertakings in the field of education, including the education of adults;
6. Undertakings in the field of regional and local culture which are components of national culture, as well as, the protection and development of cultural heritage;
7. Investments improving the condition of the environment;
8. Development of institutions undertaking actions aimed at stimulation of activity and supporting self-governing activities of regional and local communities;
9. Studies and research necessary to conduct regional development policy;
10. Other tasks related to supporting regional development.

The regional contract specifies the scope, procedure and conditions of implementation of, firstly: tasks consequential to regional programs which have received the Government’s support and, secondly: tasks included among issues supervised by competent ministers, supported by local government units and other authorised entities. The parties to the contract are the Council of Ministers (i.e., the Government party, and the regional government – the local government party). In negotiations, a Minister represents the Government party, and a marshal, a chairman of regional board, represents the local government party. The contract provisions and changes to those provisions account for the national regional development strategy. The signed contract must be approved by the council of the particular region and by the Council of Ministers.

The administration of the region, when applying for support from the State budget, submits an application to the competent minister for the assignation of funds. The application must be filed within one month following the announcement of the regulation on the Government support program by the Council of Ministers, who specify the scope, procedure and conditions of support for regional projects from the State. The application must contain:

- Purposes for which the support is to be granted (consistent with the directions and priorities of the State regional development policy contained in the strategy and their specification contained in the Government program of support for the development of regions);
- The list of works for which the support is to be granted;
- Sources of financing of the works planned and the amount of funds from each of those sources;
- The expected results of the implementation of the works and indices for the evaluation of those effects;
- Expectations concerning the company and the amount of support;
- The specification of eligible entities (i.e., implementing works consequential to the regional contract);
- Information about the progress of consultations with institutions, which have influence over the region's economy, conducted in relation to the application.

Together with the application, the administration of the region submits the regional development strategy as well as programs, or the regional program. If a regional contract is providing for the works of the local government unit, it is obliged to file an appropriate application to the regional government.

The contract must specify:

- The term of the contract;
- Tasks covered by the contract;
- The procedure and schedule of implementation of tasks, as well as the rules of the supervision of their implementation;
- The specification of eligible entities;
- The total expenditure on the implementation of tasks covered by the contract, as well as the scope, method and sources of financing of those tasks;
- The method of and deadline for financial settlements;
- The scope and procedure of reporting;
- The rules of evaluation and method of control of the implementation of tasks, including financial control;
- The procedure applied in the case where irregularities have been found in the implementation or the financing of tasks;
- The rules and procedure for the resolution of disputes and satisfaction of claims against the parties to the contract, including financial claims;
- The rules of termination of the contract and of making amendments to the contract;
- The rules and procedure of satisfying claims by eligible entities in the case of an amendment to or termination of the contract;
- The procedure of appointment, the composition, and the tasks of the regional monitoring committee, which will be evaluating the effectiveness and the quality of implementation of the contract.

In accordance with the Act, within 30 days following the receipt of the application from the voivodship administration by the Minister, negotiations should commence, and they should be completed within no later than 30 days following the announcement of the Budget Act.

The Act on Regional Development Support Principles, also provides for the possibility of terminating the contract or introducing amendments to it. The contract may be terminated on the basis of the declared consent of the parties or as of the end of the notice period when the contract is terminated by one of the parties. The contract may also be changed with the declared consent of the parties or on notice of one of the parties after negotiations, which call for the parties to amend the contract after the expiry of the deadline. Unless the parties to the contract agree otherwise, the deadline for calling the parties to amend or terminate the contract shall be one month from the date of issuance of a call to the local government party by the Minister to amend or terminate the contract, or from the date of notification by the Minister about the call to amend or terminate the contract, the decision, which is made by the authorised body of the regional board.

The limit of expenditure on support for regional development is determined in the Budget Act. If the program covers a period longer than one year, the Budget Act also specifies the limits of expenditure in the budget year and in the following budget years. In the second or following year of implementation of the Government's regional development support program, the limit of expenditure is determined (i.e., on the basis of the analysis of effects obtained during the previous years of implementation of the Government program and the performance of regional contracts).

The subsidising of local government units implementing the works provided for in the regional contract, as well as the subsidy delivered through their intermediary (or other eligible entities) is granted from the State budget on terms specified in the Act on Public Finance, complying with provisions of the Act on Regional Development Support Principles. The Minister responsible for public finance forwards the funds to those units via voivods within deadlines and on terms specified in the contract. If the amounts consistent with the contract are not handed over to local government units within the deadlines specified in the contract, the units in question are entitled to interest on the amount provided for in the contract and, if the contract does not state that amount, for the statutory amount.

The obtaining of funds from the State budget by the voivodship administration on the basis of the contract does not preclude the possibility of using other forms of funding for the tasks within the scope of regional development support for that voivodship, consequential to international agreements signed as well as separate provisions.

The Regulation of the Council of Ministers of December 28, 2000 concerning the adoption of the Support Program for the years 2001-2002 provides funds for implementation for the amount of PLN 5,906,920,000, including:

1) funds provided in 2001 – PLN 2,686,380,000;
2) funds provided in 2002 – PLN 3,220,540,000.

The limit of budgetary expenditure of the State amounts to PLN 3,451 million in total, including: funds provided in 2001 – PLN 1,451 million, and funds provided in 2002 – PLN 2,000 million[23]. These amounts must be spent in the years 2001-2002; they have been earmarked for the financing of the following activities covered by the support program:

- Subsidising of works consequential to regional programs, to be covered by regional contracts, including multi-annual investments of local government units, among them the Warsaw underground railway system, which are:
  a) funds specified in the calculation of limits for regions to clear multi-annual investments of local government units;

[23] In the 2001 Budget Act the same limits were specified for the years 2000-2001 as those provided for in this Regulation, in the 2002 Draft Budget, the amount of PLN 1,000,000 was allocated for the financing of tasks covered by the Government's regional development support program.

b) funds specified in the calculation of limits for regions as subsidies for investments and investment purchases implemented by eligible entities on the basis of agreements with Government administration bodies (the minimum support amount provided for this purpose in the years 2001 and 2002 jointly for a region, amounts to PLN 20 million);
c) funds specified in the calculation of limits for regions as subsidies for investments in the area of health protection for local government units;

- Subsidising of investments and investment purchases of local government units from funds which are at the disposal of voivods (representing the central government) and implemented under tasks specified in Appendix 1 to the support program.

Moreover, the limit of funds for the commitments of the State budget, amounting to PLN 2,455,802,000, include: funds provided in 2001 (PLN 1,235,262,000), and funds provided in 2002 (PLN 1,220,540,000), where the amounts mentioned are declared in EUR, divided by 4 and multiplied by the current exchange rate of EUR to PLN). Those amounts may be spent after the end of 2002, until the conclusion of the PHARE Program. The funds mentioned have been earmarked for the funding of the following activities:
- Subsidising of the PHARE Socio-Economic Cohesion Program from the State budget,
- Subsidising of the PHARE cross-border cooperation programs and the Polish Eastern Border Integrated Program from the State budget, with the exclusion of works implemented within that scope by Government administration bodies,
- Funding of the PHARE Socio-Economic Cohesion Program from the European Community budget,
- Funding of the PHARE cross-border cooperation programs and the Polish Eastern Border Integrated Program from the European Community budget, with the exclusion of works implemented within that scope by Government administration bodies.

The regulation provides that the amounts assigned shall be earmarked for individual priority objectives based on the following proportions:
- Development and modernisation of the infrastructure used for the enhancement of competitiveness in regions - 50 percent
- Restructuring of the economic base of regions and creation of the conditions for its diversification - 15 percent
- Human resources development - 12 percent
- Support for areas requiring activation and threatened by deterioration - 18 percent
- Development of the cooperation of regions – 5 percent

The division of funds in individual regions may differ depending on the socio-economic situation and the regional development strategy implemented. Moreover, 80 percent of funds is divided among all regions proportionally to their population, 10 percent of funds is divided proportionally to the population among regions in which the level of the gross domestic product (GDP) per inhabitant is lower than 80 percent of the average gross domestic product per inhabitant. 10 percent of funds is divided proportionally to the population in provinces in which the rate of unemployment exceeds 150 percent of the average national unemployment rate in each of the last 3 years.

The Regulation provides that shares of individual region will be as follows:

Lower Silesia	7.72 %
Kujawsko-Pomorski	5.68%
Lubelski	7.30%
Lubuski	2.79%
Łódzki	5.69%
Małopolski	6.67%
Mazovia	11.27%
Opolski	2.71%
Podkarpacki	7.04%
Podlaski	3.99%
Pomerania	5.84%
Silesia	10.19%
Saint Gross	4.62%
Warmińsko-Mazurski	6.49%
Wielkopolski	7.05%
West Pomerania	4.96%
POLAND	100.00%

The legal solutions used in the regional contracts are completely consistent with the EU Structural Funds principles. As we can see above, shares to individual regions are differentiated: the higher the percentage, the poorer the region. So the state budget supports regions whose development is lagging.

4.7 CAPITAL INVESTMENT FINANCED THROUGH SERVICE FEES (BY INFRASTRUCTURE COMPANIES)

In Poland, a significant part of local and regional development is realized through the operation of commercial infrastructure companies, which provide supplies of electricity, heat, natural gas, water and sewage treatment. In all communities, properties of infrastructure enterprises are separated from property of the community (municipality, city, county, etc.). The prevailing legal form of organizing infrastructure companies is the limited liability company or the joint stock company. Nearly all of them are 100 percent community-owned or their union-owned. In water supply and sewage treatment, only one enterprise is 51 percent held by a private owner (Saur Neptun Gdansk). The percentage of private ownership of infrastructure companies grows in electricity and heat distribution. Natural gas distribution is managed by the state company PGNiG which is now in the process of privatization. Another issue is postal service and telecommunication, which should also be considered an important infrastructure service, being significant for local and regional development. The Postal service is a joint stock company owned by the state. Polish telecom TP SA is a joint stock company owned jointly by France Telecom and its partners, and the state treasury. The telecom TP SA is under the process of privatization.

Within the period of 1990-2000, huge improvements were observed in providing infrastructure services for population. The following table shows changes in Polish infrastructure within the period of 1990-1999.

Table 27. Changes in Infrastructure Services in Poland

Infrastructure services or parameters	1990	1993	1994	1995	1996	1997	1998	1999	1999-1990 (=100)
Water consumption (in hm^3)	14,247	12,277	11,978	12,065	12,008	11,799	11,313	11,274	79.1
Untreated or partially treated wastewater (in hm^3)	5,457	3,995	3,992	3,719	3,524	3,369	3,225	3,041	55.7
Air pollution emission (gases - in tons)	4,115	3,001	2,941	2,785	2,672	2,460	2,267	2,169	52.7
Length of water lines (in kms)	93,187	126,527	142,179	154,688	168,879	183,353	194,711	203,626	218.5
Length of sewage lines (in kms)	26,515	30,087	31368	33,511	35,866	39,223	42,962	46,752	176.3
Length of gas lines (in kms)	45,827	67,981	74595	79,352	83,699	87,544	91,289	94,676	206.6
Wire telephone subscribers (in thousands)	3,293	4,416	5006	5,728	6,532	7,619	8,808	10,076	306.0
Post offices	8,041	8,110	8189	8,303	8,361	8,398	8,387	8,379	104.2

Source: Main Statistic Office, Statistic Yearbook 2000

The data presented in the table above show significant progress in infrastructure in Poland. In the nineties, water consumption decreased by about 20 percent, the quantity of untreated wastewater decreased by 45 percent and emission of gas air pollutants by 48 percent. In the same period, the length of water lines increased by 118 percent, sewage lines by 76 percent, gas lines by 106 percent. The number of wire telephone subscribers increased three times. Only the increase of post offices was limited to 4.2 percent.

The data presented above show that the infrastructure progress was very important. This progress occurred due to massive capital investment in infrastructure companies. The patterns of implementing capital investment in Polish infrastructure changed significantly within the period of the nineties.

Table 28. Capital Investment Expenditures of Infrastructure Companies

Capital investment expenditures of infrastructure companies	1993	1994	1995	1996	1997	1998	1999	2000
Supply of electricity, gas, heat and hot water, water supply and purification (ECU/Euro equivalent)	3,570 (1,492)	4,869 (1,637)	6,768 (2,140)	8,770 (2,464)	10,026 (2,586)	10,255 (2,497)	10,606 (2,544)	9,138 (2,361)
Post and telecommunications (ECU/Euro equivalent)	1,482 (619)	1,723 (579)	2,590 (819)	3,938 (1,107)	6,474 (1,670)	8,402 (2,046)	9,446 (2,266)	10,320 (2,667)
TOTAL in M PLN (ECU/Euro equivalent)	5,052 (2,111)	6,592 (2,216)	9,358 (2,959)	12,708 (3,571)	16,500 (4,256)	18,657 (4,543)	20,052 (4,810)	19,458 (5,028)

Source: Main Statistic Office. PLN in millions(current prices)

According to data presented in the table above, the capital investment of infrastructure companies in the period of 1993-1999 increased about 4 times in current prices and in real terms, measured by the ECU/Euro these values increased from ECU 2,021 million to ECU 5,810. This means that capital investment increased by 187.5 percent within a period of 6 years. In 2000, there was a slight decrease of capital investment observed (but in PLN, in euro the capital investment increased by 4.5

percent). This was primarily caused by the slow-down in the Polish economy and the reduction in demand for new capital investment. Another factor was the decrease of the euro exchange rate. The discussed data present how broad the progress was in nineties. Capital investment in infrastructure companies allowed a significant part of population, mostly living in rural areas to increase their living standards.

The rules of implementing capital investment in favor of infrastructure companies changed significantly within the period of 1990-2000. At the beginning of the decade, most capital investment was implemented by local governments and, after completing particular projects, the new property was transferred to infrastructure companies as a gift. This solution is still broadly used by local governments when purchasing transportation means for local transportation systems. When a property is freely transferred to the communal company, it allows for fiscal depreciation of property and is very beneficial for VAT withdrawal. However, the prevalence of this method of financing is decreasing.

In the first part of the nineties, local governments heavily subsidized the operation of infrastructure companies. The highest priority was to maintain low prices for water, wastewater purification, electricity, commercial heat (warm water) and natural gas. Only telecommunication and postal services were organized in a way, which allowed profits. With time, the approach to municipal services provided by infrastructure companies changed significantly. Local governments had growing financial needs (both for current and investment purposes) and therefore, decided to reduce the subsidy rates. Despite the fact that electricity and natural gas deliveries were implemented by state owned companies the same approach was used by the central government. As a result, subsidized prices of energy, water, gas and water purification disappeared and prices for these products and services increased many times. In the second part of the nineties the central government increased the VAT rates for energy means from 7 to 22 percent. This made the process of price increases stronger.

There were three main ways of implementing capital investment by, or in favor of, infrastructure companies:

1. The first method was based on financing the capital investment by the community or by future consumers. After completion of the construction, the property was transferred as a gift to infrastructure companies for maintenance. This method declined significantly. However, the idea that future consumers would invest their own money in building infrastructure remained. The organizational form of financing infrastructure investment by future consumers is based on so-called ‘social investment initiatives’. Local people built waterlines on their own: they employed a professional designer, who prepared the technical design, applied for a construction permit and the waterline was built by them (also through their personal input of work). These activities of local people were usually 30-50 percent subsidized by local governments. In fact, these infrastructure investments were implemented very cheaply and local governments were very willingly to support such initiatives. After completion, the waterline was transferred freely as a gift to infrastructure companies for maintenance. Usually, short connections of networks (e.g., from main line to particular houses) are financed by future consumers. If we consider this way of capital investment financing, it is possible to admit that it is decreasing.
2. The second most important way of capital investment financing is borrowing by infrastructure companies and increasing prices of products during repayment of loans and bank credits. This way is mostly used when an infrastructure company borrows money for new investments from the bank and increases the value of capital investment. To some extent, this way prevailed by improving technology procedures of distribution of heat to housing. Significant credits were taken out from international institutions and Polish banks.

3. The third way of financing capital investment by infrastructure companies is financing investment from gross margin, which always requires the increase of prices. This is important, in that, price increases are immediate and not popular with the population.

In fact, all three methods are used simultaneously.

In postal and telecommunications, the same methods were also used but the role of local governments in implementing capital investment was significantly smaller. The state treasury was the owner of these companies and was responsible for their development. Both Polish Post and Telekom TP SA financed numerous investments both from prices increases, and from borrowing (also bonds issuances). The role of local governments was to facilitate the development of this infrastructure.

Summarily, it is necessary to underline that the value of capital investment effected by infrastructure companies was higher than the value of capital investment of local governments. This shows that the free enterprise sector plays the most important role in developing local and regional infrastructure.

In analyzing financing capital investment compliance with the principles of EU Structural Funds through service fees it should be underlined that infrastructure companies in general, do not benefit from public aid and therefore such compliance is not required. However, the prices for energy, electricity and natural gas require acceptance of the Office for Regulating of the Energy Sector. Prices for water supply and sewage treatment require acceptance of relevant communities and municipalities. Other prices in the infrastructure sector are free of regulation.

4.8 EUROPEAN UNION PROGRAMS

Presentation of Main Programs

Financial Assistance of the European Union remains important source of capital investment funding in Poland. Currently pre-accession assistance, planned till 2006, is provided within the framework of three programs: PHARE, ISPA and SAPARD. PHARE provided assistance to Poland, staring from 1990 and its main objective during 1990-1997 was to support the transformation process towards a market economy and a democratic society. However, also in these years PHARE assistance was used to support the development of infrastructure, as well as to support the changes in the legislation, to develop civic society and to a build strong SME sector. It was also used to develop local and national administration.

PHARE - New orientation

The beginning of the negotiation process with the EU in 1998 influenced a change of PHARE orientation. The main objective of the new PHARE is to prepare Poland for membership in EU structures. Support provided within the PHARE framework is focused on issues described in the Accession Partnership and in the National Program of Preparation for membership in EU. Within the new orientation it was decided that 30 percent of yearly allocation would be contributed to Institution building and 70 percent for investment projects.

Institution-building projects are focused on public administration and responsible for implementation of *acquis communautaire.* Special attention is put on the preparation of human resources in regional administrations for participation the EU structural policy. It is oriented on institution building in the areas presented in the Accession Partnership documents (e.g., agriculture, environmental protection, judiciary system, social policy, consumers protection). The basic purpose of Institution Building programs is to create twin EU institutions. Most of the funds are used to cover the costs of EU experts working in partner institutions in Poland also for to cover the costs of conferences, seminars, study tours and internships.

The main objective of investment projects is to adjust infrastructure in Poland to EU standards. Starting from year 2000, investment is conducted in the following forms:

- Investment in infrastructure necessary for implementation of *acquis communautaire* and EU standards. This includes investment in the judiciary system, border control, sanitary control, regulations, work safety, etc.;
- National Aid Schemes. Investment in development of selected regions, presented in the Draft National Development Plan. These include projects especially related to environmental protection, SME development and food safety standards;
- Investment in Social and Economic Cohesion, which supports projects similar to those of the EU Structural Funds.

According to Financial Memoranda, concluded on December 31, 1999, the value of EU support within PHARE 1999 would be 287.1M EUR. The PHARE 1999 Project could be contracted till September 30, 2001, and would be executed until September 2002. Payments should be complete by September 30, 2002. PHARE 1999 allocations are presented in following table:

Table 29. Allocation of PHARE 1999

Program	Allocation in EUR millions
National Operational Program PHARE 99	213.5
Large Scale Infrastructure Facility Part 4 and 5	29.1
PHARE 2000/2001 Facilitation of Project preparation	4.5
Consensus III	2.0
Cross Border Cooperation - Poland - Czech Republic	3.0
Cross Border Cooperation - Poland - Germany	32.0
Cross Border Cooperation - Baltic Region	3.0
TOTAL	287.1

Source: IPED on the basis of Financial Memoranda.

Besides the programs mentioned, Poland also obtained 10M EUR for Participation in the Fifth Framework Program on research and technological development; an additional EUR 12 million for other Community programs and EUR 5 milliion for TEMPUS Program. The total amount of EU contributions within PHARE, Multinational and Community programs amounted to EUR 314.1 millioin for 1999. Among the most important investments financed within PHARE 1999, the following projects should mentioned:

- Modernization of the Railroad Legnica, Opole, Wroclaw EUR 38 million
- Construction of the Highway A-4 EUR 20 million
- Support to public administration and border control EUR 17.5 million
- Veterinary Control on the borders EUR 8.15 million
- Modernization of the Milk processing EUR 8.0 million

In Agenda 2000, the EU implemented further reorientation of PHARE programs, focusing investment support on two areas:

- Investment in infrastructure necessary for implementation of *acquis communautaire* and EU standards;
- Investment in Social and Economic Cohesion, which supports projects similar to EU Structural Funds. The beneficiaries of this part of the programs, mentioned in the Draft National Development Plan, are 5 regions with main economic indicators significantly

below average or with structural problems. (Podlaskie, Lubelskie, Warmińsko-mazurskie, Podkarpackie, Śląskie).

Originally, the amount of EUR 398 million was allocated for Poland within PHARE 2000. However, after negotiations, that amount was increased to EUR 484.37 million. Main programs are presented in following table:

Table 30. Allocation of PHARE 2000 in Poland

Program	Allocation (in M-EUR)
National Operational Program part I	183.0
National Operational Program . Part II	130.0
Cross Border Cooperation Program Poland- Germany	44.0
Cross Border Cooperation Program . Poland -Czech Republic	5.00
Cross Border Cooperation Program, Poland –Slovakia	4.00
Cross Border Cooperation Program , Baltic Sea Region. Modernization of the Sewage Water Treatment Plant in Krynica Morska	2.00
Special Actions in Favour of the Baltic Sea Region - Small Projects up to EUR 50 thousand	1.00
Supplementary Investment Facility for Poland (East Border)	40.70
Participation in: 5th RTD Framework program, and community programs Leonardo da Vinci	37.47
ACESS (Program Supporting development of Civil Society)	5.85
Participation in: 5th Framework program on research and technological development, Leonardo da Vinci II, Socrates II, Youth in 2000	30.43
Participation in SAVE II for SMEs	0.92
TOTAL	484.27

Source: IPED on the basis of Financial Memoranda

Among the PHARE 2000 programs, the two most important are operational programs. Their contents are presented in the Annexes. PHARE 2000 programs are currently in the early stage of contracting. Most of these programs would be completed by the end of 2003. PHARE 1999 programs are executed in 10-80 percent.

SAPARD (Support for Pre-Accession Measures for Agriculture and Rural Development)

SAPARD provides funds for capital investment, especially in small rural communities. Their program focuses on priorities presented in the National Program of Preparation for Membership in EU, especially for setting up structural policy for rural areas and their implementation. It also possesses components oriented to modernization of the selected food processing industries (e.g., milk , meat, fruit and vegetable processing.)

The basic document, (SAPARD - Operational program for Poland), was accepted by the Committee of the EU Integration in December 1999. Later it was discussed with the EU Commission during a relatively long procedure. Finally, a Multiyear Financial Agreement was signed on January 25, 2001. This program focuses on two General Objectives and on Complementary Components, which develop Human resources:

- Priority I. Improvement in the efficiency of the agriculture and food processing sector, including food processing and marketing of food products and investment in farming. This component would be available to all regions in Poland.
- Priority II. Improvement in the Conditions for Economic activity and creation of new jobs in rural areas. This component would especially include investment in rural infrastructure. Priority II would be focused on rural areas and small towns, with up to 7000 inhabitants. Larger cities would be excluded from the program.

- Complementary Components - Development of the Human Resources. This part would be used for professional training and technical assistance, development of local communities and re-forestation.

The following table presents the breakdown of different priorities within the SAPARD fund:

Table 31. Breakdown of SAPARD Fund Allocation To Priorities and Tasks

Priorities and Tasks	Allocation in EUR
Priority I. Improvement in efficiency of the agriculture and food processing sector	
Task 1. Improvement of the food processing manufacturing and marketing	448,320,000
Task 2. Investment in farming	208,084,148
Priority II. Improvement of conditions for economic activity and creation of new jobs in rural areas	
Task 3. Development of rural infrastructure	327,780,000
Task 4. Differentiation of economic activity in rural areas	136,040,000
Complimentary Activities	
Task 5. Pilot project supporting local community and re-forestation	22,920,000
Task 6. Professional training	25,610,000
Task 7. Technical Assistance and access to beneficiaries	8,659,686
	1,177,413,834
Technical Assistance in accordance with § 7 no 1268/1999 SAPARD input 100%	23,803,764
TOTAL	1,201,217,598

Source: Agency for Restructuring and Modernization of Agriculture

Due to significant problems with accreditation of the Agency for Restructuring and Modernization of Agriculture, responsible for program implementation, SAPARD is still in an early stage. Currently institutions involved in its implementation are passing through an audit. The Annual Agreement concerning EU commitment for 2000 was concluded on March 29, 2001. This agreement set up the EU financial obligation at the level of EUR 171,570,075. Originally, this fund should have been distributed by December 31, 2002. Due to the program delay, that date is postponed until the end of 2003. The program will start after SAPARD Agency accreditation is completed[24].

ISPA (Instrument for Structural Policies for Pre-Accession)

During the years 2000-2006, another important element of capital investment funding will be the ISPA program. It is anticipated that ISPA will provide Poland with the amount EUR 312-384.8 million yearly for investment in transport infrastructure and environmental protection. Its main objective is to prepare Poland for EU membership in the area of transportation and environmental protection.

- In the area of transportation, ISPA supports projects, which facilitate inclusion of the Polish transportation system into Trans European Network (TEN).
- In the area environmental protection, ISPA supports investment in sewage water treatment, waste treatment, projects scaling down air pollution or improving drinking water.
- ISPA can support projects, groups of projects and project phases.

Currently following ISPA projects are implemented in Poland, with a total value of ISPA support at the amount of EUR 991,175,188. Current ISPA projects in Poland are presented in the Annexes.

[24] Information based on www.cie.gov.pl/fundusze/sapard/actual.

ISPA generally finances large projects, starting from EUR 5 million, to assure significant impact on the improvement of the infrastructure. Transportation projects generally have a maximum ISPA input (75 percent) and are prepared by the National Administration. Road projects are prepared by the General Directorate for Public Road and for Railroads projects, the Polish Railroads.

Applications for environmental projects are prepared by local government units. The agency responsible for those projects is the National Fund for Environmental Protection. Generally speaking, ISPA is oriented for large projects, especially in transportation, while PHARE is focused on regional issues and SAPARD on the municipality/community level.

Rules and Procedures of Distribution

PHARE programs are prepared on the basis of a two-year programming process. Draft projects are sent to the EU Commission prior to the budget year by the national and regional administration. Later, after negotiations, final PHARE programs are concluded in the form of financial memoranda. This completes the programming phase and starts the implementation phase. A list of projects, included in the Financial Memorandum is executed through implementing agencies. Detailed procedures concerning project execution are standardized in the Practical Guide to PHARE, ISPA, SAPARD Contract procedures[25]. This manual includes eligibility criteria, especially concerning rules on nationality and country of origin, exceptions from those rules, contract award procedure with different tender procedures, methods of contracts modifications, and rules concerning co-financing.

PHARE funds can be distributed to public administration units. Proposals from the national administration and its regional branches should be send to their respective Ministries. The Ministries prepare project fiche and, through the Office for EU Integration, they are sent to the EU Commission. Local governments prepare project fiche and send them to the Marshall Office (Regional Government). Each project should have feasibility study and impact study. The regional government is responsible for evaluation of whether the proposal meets the set criteria. Projects should meet the criteria set up in the National Program of Preparation for Membership in the EU[26] and should be in compliance with the Regional Development Strategy. The Regional Parliament accepts selected projects. The Selection process is conducted with participation of the PARD (Polish Agency for Regional Development) representative. Selected projects are transferred to the EU Commission through the Ministry of Economy or through the Office for EU Integration.

Part of the fund is distributed through so-called ‘grant schemes’. These funds are mostly targeted to NGOs, research organizations, companies and also parts to local authorities. Grant schemes are targeted to generally described beneficiaries. They describe individual criteria for project selection, methods of evaluation, time schedule, eligible organizations/persons.

In the case of SAPARD, detailed criteria are connected with each program task. Criteria concerning Priority 1: Improvement of the efficiency of the agriculture and food-processing sector, include:

In the area of meeting program objectives:

- Impact on adjustment to EU Sanitary and Veterinary requirements;
- Improvement of quality of food processing, implementation of new technologies, innovations and cost reductions;
- Positive impact on environmental protection;

[25] Practical Guide 2001, p.170

[26] National Program of Preparation for membership in European Union Approved by the Council of Ministers of the Republic of Poland, June 12, 2001. Document include 30 group of priorities divided by tasks which correspond with negotiations areas.

In the area of impact on program efficiency:

- Amount of co-financing of applicant;
- Management quality;
- Subvention for the unit of agriculture product, processed according to EU requirements;

In the area of impact on local development:

- Creation of the new jobs;
- Input to development of local manufacturing.

Support to farm development is planned for those farms, which meet the criteria set up for each branch of farm production. Those criteria include:

- Level of production;
- Target level of production;
- Contracts for delivery of farm product to processing company;
- EU standards farms should meet after the investment process[27].

Criteria concerning Priority II: Improvement of the Conditions for Economic activity and creation of the new jobs in rural areas, include:

- Level of Municipality/community income per capita (Preferences for municipalities with lower income);
- Investment costs per target beneficiaries;
- Number of potential beneficiaries (Preferences for the projects proposed by the group of municipalities);
- Number of inhabitants with access to water supply (Preferences for Municipalities with access to water supply lower than average);
- Adjustment of the investment with Regional development strategy;
- Level of co-financing by beneficiaries;
- Demographic situation of the municipality/community (Preferences for Communities with high birth rate in 1989-1999);
- Unemployment rate (Preferences for municipalities/communities with high unemployment rate).
- Investment impact on the creation of the new jobs;
- Preferences for Municipalities/communities investing in both: water supply and in sewage water systems[28].

Regarding the ISPA program, it allows for financing feasibility studies, planning and designs with environmental impact assessment, site preparation, building and construction, plant and machinery installation, testing and training, project management, compensatory or mitigation measures of the of the environmental impact. Environmental projects are selected on the basis of following criteria:

- Consistency with EU environmental policy objectives (Art.130 R of the Maastricht Treaty), in particular with objectives of preserving, protecting and improving the quality of the environment, protecting human health and assuring prudent and rational utilization of natural resources.
- Consistency with the EU environmental principles, in particular with the precautionary principle, preventive action principle, elimination of pollution at its source and the Polluter Pays Principle.
- Focus on priorities listed in National Program of Preparation for membership in EU.
- Effect of scale. Level of reduction of pollution for a maximum number of people.

[27] SAPARD. Operational Program for Poland. September 2000, pages 59-81
[28] Op.cit, . 83-140

- Impact of implementation of the new national Environmental Policy.
- Potential to stimulate partnership between regional and local authorities, aimed at fast development of regions through utilization of regional characteristics of human and environmental resources. Regions of special focus are the Bialowiela Forest, the Drawienski National Park, the Podhale region, the green belt around Warsaw.
- Contribution to protection of ecosystems of extraordinary value from the point of view of nature protection.
- Potential to contribute to gradual achievements of economic and social cohesion of Poland with the EU. Projects showing the highest economic and social benefits[29].

Criteria for ISPA transportation projects include:
- Location of the project. Projects should be located on international roads, which after Polish integration with the EU, would be part of TEN. List of those roads (TINA) was agreed upon with the EU Commission;
- Impact of integration of the Polish transportation system with TEN;
- Impact on modernization of the Polish transportation system;
- Continuity of the previous activities, oriented on modernization of the Polish transportation system[30].

All investment supported by ISPA must be economically efficient. However, this does not mean that it must ensure financial profitability. Efficiency needs to be proved by social costs and benefit analysis.

All three programs play a special role in Poland. Their EU origin determines the procedures and criteria concerning investment spending. These programs meet the EU Structural Fund's main principles: concentration, programming, partnership and supplementary financial relations, but it does not assure smooth distribution of the UE funds. The main problems are described below.

Main problems of distribution

Problems with distribution of EU funds for capital investment are related to lack of knowledge and cost of project preparation. Knowledge about preparation of the project fiche on a municipality level is not very widespread, and only a few of the municipalities are familiar with the procedures. The cost of hiring external consultants is too high, especially for municipalities with low budgets. Also the cost of elaborating a feasibility study is high. Additionally, municipalities with low-level income have problems with matching funds. Investment projects require at least 25 percent co-financing. However, the average co-financing for an environmental project in ISPA is 40 percent. SAPARD prefers larger than minimum co-financing.

The next group of problems is related to targeting the beneficiaries. Information about the availability of EU funds is distributed by regional authorities. Though they are also accessible on the web pages of the EU Information Centers and Implementing Agencies, not all municipalities have access to the internet and knowledge of how to find the information on potential programs. Therefore, SAPARD reserved part of the funds to improve access to potential beneficiaries.

[29] Strategy for using ISPA funds as a subsidiary Instrument for Implementation of the national Environmental Policy, Ministry of Environment 2001, p. 19-21
[30] National Strategy for Transportation System in Poland, p.10-14.

5. Evaluation of Sectoral and Regional Funding Mechanism

Local government budgets remain a more important source of capital investment in Poland than sectorial allocation by the central government. Local governments spent over 3.5 billion EURO on capital investment in the year 2000, while capital investment expenditures from the central budget to sectors remain on the level of about 1.4 billion EURO. The most important source of capital investment remains infrastructure companies, which invested over 5 billion euros in 2000. The current funding mechanism allowed for significant improvement of the infrastructure. During the last decade the total length of water supply lines and gas lines was doubled. The number of wire telephone subscribes increased three times. The length of sewage water lines increased by 76 percent and quantity of untreated wastewater decreased by 48 percent.

Considering the importance of local government spending on infrastructure investment, one may say that funding mechanisms created with the implementation of local self-governments prove to be efficient. Local governments budgets are required to secure the funding for covering the costs of their works and later they may decide on a level of capital investment on the basis of local needs. A relatively small amount of capital investment funding is decided by the national administration[31] in the form of donations for designated investment projects. Local governments, especially those authorities, which elaborated local development strategies, are more familiar with local needs and preferences. Aside from this, they spend the funds more efficiently than national authorities and have more opportunities to build public - private partnerships to execute investment projects. All these factors contributed to greater efficiency of the regional funding mechanism in Poland.

Changes related to implementation of self-governing counties and regions in 1999 increased the scope of funds distributed on a regional basis. Efficiency of the regional funding mechanism determined the transfer of part of sectorial investment to regional level. Regional contracts replaced partly centralized investment programs, financed by the state budget. Those changes allow better adjustment of investment programs to local needs. Regions, with the participation of municipalities/communities, counties and social partners prepared local development strategies, which included the most important investment projects, necessary for economic development. Later, regions, within the framework of regional contracts, obtained the funds to cover part of the cost of planned investment expenses, which previously were distributed on a sectorial basis.

The scope of capital investment, executed by local governments, depends to a large extent on disposable revenues. Local government funding in Poland includes a mechanism oriented to scaling down regional/local disparities. However, this is not sufficient to speed up the development of poorer regions. Disparities are partly diminishing through the preferences for the low revenues that regions set up in the framework of EU programs. However, the still-current regional mechanism is more vulnerable to regional disparities. On the other hand, it supports the initiative of local governments in their efforts to increase the local revenues by attracting investment and new taxpayers.

Disparities in revenues are also diminishing through the functioning of the state agencies, focused on designated sectors like agriculture, environmental protection or heavy industry. In this case, the efficiency of the sectorial mechanism depends on the criteria and selection process of beneficiaries. Generally, those mechanisms are more vulnerable to the discretion of agency administration. Funding mechanisms based on the decisions of local authorities are more efficient in meeting the local needs.

[31] In the year 2000 it was 91,5 millions EURO

Appendices

Appendix 1. The Projects Conducted by ARMA

Field Form of Assistance	For whom	Amount	Interest	Repayment
AGRICULTURE				
Credit for implementation of investment undertakings in agriculture, agri-food processing and services for agriculture	Eligible private individuals, with the exception of pensioners and disability pensioners, legal persons, organizational units without legal personality	Up to 80% of the value of investment layouts per undertaking, on activities within the field of agro-tourism and veterinary practice, no more than PLN 2M; up to 70% of the value of investment layouts for off-farming sectors and for agricultural services, no more than 4M PLN; up to 70% of the value of investment layouts for agri-food processing, no more than 8M PLN	Floating, currently between 9.78% and 10.63% p.a.	8 years Max, possible 2-year grace period for repayment of principal
Credit for the purchase of farm land	as above	Up to 80% of the contractual price of farm land, no more than PLN 2M	Floating, currently 4.25% p.a.	15 years Max, possible 2-year grace period for repayment of principal
Credit for the establishment or organization of farms by persons who are under 40 years old	Eligible private individuals, Eligible disability pensioners	Up to 80% of the value of investment layouts per undertaking, no more than PLN 2M, up to 70% of the value of investment layouts for off-farming sectors, no more than PLN 4M	as above	as above
Credit under the "milk industry program"	Eligible private individuals, excluding pensioners and disability pensioners, legal persons, organisational units without legal personality, starting or already producing cow milk/ conducting milk processing	Up to 80% of the value of investment layouts per undertaking, no more than PLN 2M; up to 70% of the value of investment layouts for agri-food processing, no more than PLN 8M	floating currently between 4.89% and 5.31% p.a.	8 years Max, possible 3-year grace period for repayment of principal
Credit under the "Industry program of common utilization of farm machines and equipment"	Eligible private individuals, excluding pensioners and disability pensioners, eligible legal persons	Up to 80% of the value of investment layouts per undertaking, no more than PLN 2M per group, up to 70% of the value of investment layouts for undertakings implemented by private individuals operating off-farming sectors and forming groups of common utilization of farm machines and equipment, as well as individuals, no more than PLN 4M	as above	as above

Source: Own study based on information from the ARMA.

Appendix 1. The Projects Conducted by ARMA - CONT'D

Field Form of Assistance	For whom	Amount	Interest	Repayment
Credit under the "Industry program of development of fishing in Poland for the years 2000-2006 – Investments in inland fishing"	Eligible private individuals, excluding pensioners and disability pensioners, eligible legal persons and organisational units without legal personality	Up to 80% of the value of investment layouts per undertaking, no more than PLN 2M	as above	as above
Credit under the "Industry program of restructuring the processing of potatoes into starch in Poland "	Eligible private individuals, excluding pensioners and disability pensioners, legal persons, organizational units without legal personality	as above	as above	as above
Credit for the creation or organization of a farm under the farm settlement program on the land of the State Treasury	Eligible private individuals, excluding pensioners and disability pensioners	Up to 95% of the value of investment layouts per undertaking, no more than PLN 2M	Floating, currently between 4.25% and 10.63% p.a.	15 years Max, possible 3-year grace period for repayment of principal
Credit for the implementation of undertakings in agriculture in off-farming sectors, aimed at using the existing production base of farms and off-farming sectors by starting or increasing production in those farms and off-farming sectors	Eligible private individuals, excluding pensioners and disability pensioners, legal persons, organisational units without legal personality	Up to 80% of the value of investment layouts per undertaking, no more than PLN 2M, up to 70% of the value of investment layouts for off-farming sectors, no more than PLN 4M	as above	3 years Max, with the exception of credits for undertakings in the production of milk, which may be contracted for 4 years. Grace period in the repayment of principal up to 1 year
Investment credit for the elimination of the effects of flood, investment credit for the resuming of production in farms and off-farming sectors located in areas affected by a natural disaster	Eligible entities	May not exceed the replacement value of fixed assets, no more than PLN 2M per undertaking or PLN 4M for off-farming sectors	Floating, currently 4.25% p.a.	5 or 8 year Max, possible 1 or 2 year grace period for repayment of principal

Source: Own study based on information from the ARMA.

Appendix 1. The Projects Conducted by ARMA - CONT'D

Field Form of Assistance	For whom	Amount	Interest	Repayment
Revolving credit for the resuming of production in farms and off-farming sectors located in areas affected by drought, hail-storms, excessive rain and snow, freezing, flooding, hurricane, fire or infestation with rodents	as above	May not exceed the estimated value of losses of a farm or of a special sector of farm production in farm crops, livestock or assets used for farm production, no more than PLN 2M per undertaking or PLN 4M for off-farming sectors	as above	
Revolving credits (credits for purchasing assets for farm production)	Eligible domestic entities conducting farm production		6.8%	12-24 months
Credit guarantees and sureties	Eligible private individuals and legal persons as well as other entities which are not legal persons	The surety is a fixed-term one and may be granted for up to 60% of the utilized amount of the credit awarded and interest on the amount covered by the surety, no more than PLN 1M; guarantees are fixed-term ones and may be granted for up to PLN 1M	One-off commission – 1% of the credit amount covered by surety or 2% of the credit amount covered by guarantee	
ENTREPRENEURSHIP				
Credit for the creation of new permanent jobs in non-farming sectors in rural and rural-urban communities, and in towns with population up to 20,000 inhabitants	Eligible private individuals and legal persons	Up to 70% of the costs of the undertaking, no more than PLN 200,000, where for each PLN 20,000 of the loan granted one job must be created	0%	In instalments payable monthly or quarterly. Term of repayment up to 4 years, grace period 12 months
Loan granted for the creation of jobs in non-farming activities in rural and rural-urban communities, and in towns with population of up to 20,000 inhabitants	as above	as above	as above	as above

Source: Own study based on information from the ARMA.

Appendix 1. The Projects Conducted by ARMA - CONT'D

Field Form of Assistance	For whom	Amount	Interest	Repayment
INFRASTRUCTURE				
Construction of water supply systems, sewerages and sewage treatment plants in rural areas; construction and modernisation of roads in rural and rural-urban communities	Local communities (gminas) and inter-gmina unions, as well as towns with population of up to 5,000 inhabitants	Each unit had the right to file 3 applications in 2000 for financial assistance. The amount of financial assistance (jointly with donations from the State budget) may not exceed 50% or 75% of the costs of investment eligible for financing, up to PLN 300,000 for all applications filed		
EDUCATION				
Financial assistance for activities related to the upgrading and changing of professional qualifications of inhabitants of rural and rural-urban communities in 2001	Agricultural advisory centers, science institutes, experimental institutes, universities and schools	Up to PLN 15,000 and up t o 80% of expenditure on the undertaking implemented – regardless of the number of courses organized	5 years from date of purchase, teaching equipment may not be sold or transferred to another entity without the written consent of the President of the Agency	Required accounting for the amount received
AGRI-FOOD PROCESSING				
Credit for the implementation of investment undertakings in agriculture, agri-food processing and in services for agriculture	Eligible private individuals, excluding pensioners and disability pensioners, legal persons, organisational units without legal personality	Up to 80% of the value of investment layouts per undertaking, for activities in the field of agrotourism and for veterinary practice, no more than PLN 2M, up to 70% of the value of investment layouts for off-farming sectors and agricultural services, no more than PLN 4M, up to 70% of the value of investment layouts for agri-food processing, no more than PLN 8M.	Floating, currently between 9.78% and 10.63% p.a.	Max. for 8 years, possible 2-year grace period in the repayment of principal
Credit under the "Milk industry program"	as above	Up to 70% of the value of investment layouts for undertakings in the field of agri-food processing, no more than PLN 8M	Floating, currently between 4.89% and 5.31% p.a.	Max. for 8 years, possible 3-year grace period in the repayment of principal

Source: Own study based on information from the ARMA.

Appendix 1. The Projects Conducted by ARMA - CONT'D

Field Form of Assistance	For whom	Amount	Interest	Repayment
Credit under the "Industry program of development of fishing in Poland for the years 2000-2006"	Eligible private individuals, excluding pensioners and disability pensioners, eligible legal persons and organisational units without legal personality	Up to 80% of the value of investment layouts per undertaking, no more than PLN 2M; up to 70% of the value of investment layouts per undertaking implemented by the entity, no more than PLN 8M.	as above	as above
Credit under the "Industry program of restructuring the processing of potatoes into starch in Poland "	as above			
Credit under the "program of support for the restructuring and modernization of the meat processing industry in Poland"	Eligible private individuals, excluding pensioners and disability pensioners, legal persons	Up to 70% of the value of investment layouts per undertaking implemented in the field of slaughter, partition of carcasses or processing of meat, no more than PLN 8M	as above	as above
SERVICES FOR AGRICULTURE				
Credit for the implementation of investment undertakings in agriculture, agri-food processing and services for agriculture	as above			
Credit under the "industry program of common utilization of farm machines and equipment"	as above			
Credit under the "Milk industry program"	as above			
Other forms of assistance				
Credits for central purchasing	Eligible domestic entities		Between 7.65 and 11.9% p.a., depending on the type of credit	Between 6 and 12 months

Source: Own study based on information from the ARMA.

Appendix 2. Poland National Program. Part I. (millions EUR)

Title	Total PHARE budget	Institution building (indicative)	Investment (indicative)
Objective 1: Strengthen institutional and administrative capacity	65.01	38.35	26.66
Integrated cadastre system			
National Bank of Poland			
Public Finance			
Internal financial control at regional level			
Tax administration			
Parliamentary law procedures			
National SME development			
Fisheries administration			
Transport administration and *acquis*			
Social dialogue			
National vocational training system			
National export development			
Strengthen regional policy administration			
Regional statistics			
Strengthen *acquis* implementation at regional level			
Objective 2: Internal Market	21.00	9.12	11.88
Customs			
Certification phase II			
Competition and consumer protection			
Intellectual and industrial property rights			
Telecoms universal service			
Objective 3: Justice and Home Affairs	48.00	8.52	39.48
Twinning for border and visa policy			
Integrated eastern border management			
Border crossing in Dorohusk			
Border crossing in Kuznica			
Border crossing in Kroscienko			
Eastern border small projects fund			
Twinning for the police services			
Fight against crime			
Fight against drugs			

Source Financial memorandum

Appendix 2. Poland National Program . Part I. (millions EUR) - CONT'D

Title	Total PHARE budget	Institution building (indicative)	Investment (indicative)
Objective 4: Agriculture IB for rural development IB for agri-environment and afforestation IB for early retirement Veterinary system for laboratories and disease control Border inspection posts phase II Phytosanitary administration Food control administration CAP common market organizations Preparation for selected CAP instruments	41.60	16.70	24.90
Objective 5: Environment Strengthen environmental impact assessment Air quality assessment systems Pollution prevention and control at regional level	7.39	3.99	3.40
Total PHARE contribution (million EUR)	183.00	76.68	106.32

SOURCE FINANCIAL MEMORANDUM

Appendix 2a. Poland National Program.

Part II. Economic and Social Cohesion Budget (in millions EUR)

Title	Total PHARE budget	Institution building (indicative)	Investment (indicative)
OPERATIONAL PROGRAM OF WARMIA-MAZURY	20.33		20.33
Human resources development	3.40		3.40
SME development	2.20		2.20
Modernization of road 16 around Olsztyn	5.58		5.58
Road access to bridge over Elblag river	2.70		2.70
Environmental protection of Mazury lakes	3.75		3.75
Small scale infrastructure investments	2.70		2.70
OPERATIONAL PROGRAM OF PODLASKIE	19.60		19.60
Human resources development	2.58		2.58
SME development	3.00		3.00
Modernization of road 61	3.80		3.80
Road tunnel on bypass of Bialystock	4.32		4.32
Upgrading and marketing of Augustow channel	3.00		3.00
Small scale infrastructure investments	2.90		2.90
OPERATIONAL PROGRAM OF LUBELSKIE	25.42		25.42
Human resources development	7.55		7.55
SME development	5.90		5.90
Preservation of the waters of the Bug river	2.60		2.60
Modernization of road 698	2.80		2.80
Renovation of old town of Lublin	2.25		2.25
Small scale infrastructure investments	4.32		4.32
OPERATIONAL PROGRAM OF PODKARPACKIE	24.50		24.50
Human resources development	4.00		4.00
SME development	5.12		5.12
Upgrading of road infrastructure in the region	13.18		13.18
Environmental protection in Rzeszow	2.20		2.20
OPERATIONAL PROGRAM OF SLASKIE	37.15		37.15
Human resources development	5.78		5.78
SME development	4.85		4.85
Business infrastructure in Silesia	4.75		4.75
Road to airport of Katowice	17.45		17.45
Small scale infrastructure investments	4.32		4.32
Engineering, supervision and monitoring support	3.00		3.00
TOTAL PHARE CONTRIBUTION (MILLION EUR)	130		130

Source: Financial memorandum

Appendix 3. Current ISPA Project in Poland

Project; Environmental protection	Acceptance	Total Costs (in EUR)	ISA input (in EUR)	(in %)
Modernization of the sewage water system in Bydgoszcz	June 2000	66,240,000	32,457,600	49%
Waste treatment in Krakow	October 2000	22,730,000	14,092,600	62%
Modernization of Sewage system in Torun	October 2000	79,111,000	47,466,600	60%
Waste water treatment plant in Kraków Plaszow	October 2000	79,976,000	55,983,200	70%
Modernization of the waste water system in Szczecin	October 2000	46,397,000	30,622,020	66%
Program for waste treatment in Wroclaw	October 2000	20,402,000	13,465,320	66%
Pipe line for Pila	November 2000	8,501,659	4,335,846	51%
Modernization of the waste water treatment in Wroclaw	October 2000	65,250,000	36,540,000	56%
Modernization of waste water treatment plant in Olsztyn	October 2000	12,716,400	6,866,856	54%
Waste processing plant for Municipality Association "Reda and Chylonka"	October 2000	20,852,955	15,014,127	72%
Technical assistance for Environmental projects preparation for 13 municipalities	November 2000	4,500,000	3,412,500	75%
Waste treatment in Łodz	October 2001	21,640,000	12,984,000	60%
Waste water treatment plant in Łodz	October 2001	45,799,000	22,899,500	50%
Waste water treatment in Warsaw	October 2001	42,242,000	27,457,300	65%
Purification of water in Suwalki	October 2001	12,468,000	6,234,000	50%
Technical assistance in project preparation	October 2001	4,550,000	3,412,500	75%
TOTAL Environmental protection		553,376,014	333,243,969	60%
Transport				
Road KA4E Kleszow -Sosnica		112,282,000	84,211,500	75%
Railroad E-20 Minsk mazowiecki - Siedlce		124,595,625	93,446,719	75%
Railroad E-20 Rzepin- Polish Border		62,233,000	46,674,750	75
Modernization of the road 717		32,761,000	24,570,750	75%
Modernization of the road 7, Gdansk -Jazowa		82,832,000	62,124,000	75%
Modernization of the road 4, Krakow - Tarnow		62,233,000	46,674,750	75%
Technical Assistance Warsaw Transportation System		940,000	705,000	75%
Road Bielko Biała - Cieszyn		138,185,000	103,638,750	75%
Training in project management in transportation		400,000	400,000	100%
Technical Assistance for Modernication of the Railroad E65	October 2001	14,900,000	5,960,000	40%
Modernization of the road A4	October 2001	252,700,000	189,525,000	75%
Total - Transport		884,061,625	657,931,219	74%
TOTAL ISPA		1,437,437,639	991,175,189	69%

Source www.cie.gov.pl

Aside from the project mentioned, four new projects were also currently approved for wastewater plants in Gliwice, Katowice, Przemyśl and Poznan. Financial Memoranda concerning those projects will be concluded during the next few months.

Investing in Regional Development:

Policies and Practices in Romania

Afrodita Popa

Victor Giosan

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Table of Contents

1. INTRODUCTION

1.1 PURPOSE OF THE STUDY

Regional development plays an important role in the decentralization process that started in the countries of Central and South Eastern Europe after 1990 in three main ways:

- Allocation of funds for investments primarily to poorly developed regions narrowi the regional differences;
- Economic development involves a series of factors and measures, starting with the infrastructure development, stimulation of the labor market, environment protection etc, that are more easily treated at a regional level;
- Regional structures are the most liable to develop measures of public/private partnership necessary for economic development and growth in a market economy.

This study provides all necessary data and information for an analysis[1] of the funds used for financing capital investments in Romania that contribute to regional development.

In the current study, capital investments have been divided into three main components:

- Infrastructure;
- promotion of economic activity;
- development of human capital (only funds for the labor market development).

Funds for capital investment financing will be described according to their sources:

- The European Union;
- The State Budget;
- Off-budget revenues;
- Local government revenues;
- Revenues from loans of the local administration loans.

The regional development policies, their evolution in time, and their implications for capital investments will be also described in detail in this study.

1.2 BRIEF SUMMARY

The local government system in Romania includes the central level and the two local administration levels (the *county* level and the level of *municipalities, towns or communes*). As of 1998, an intermediary level was introduced between the central and local ones, namely, the *regional* one. The regional level is not a level of the local public administration, its role being to promote and apply the regional development policies.

Chapter 2 of the study presents the central, regional and local institutions, which play an important role in capital investment financing, and their interconnectedness from the view of the capital flow.

Chapter 3 of the study presents the history of the development policies in Romania, starting in 1998, when the concept of regional development, and that of the regional level, was introduced following the creation of Law 151/1998 on regional development. The legislative framework, the

[1] The analysis is presented in 'CAPITAL INVESTMENT FINANCING IN ROMANIA – Analysis of the Flow of Investment Funds', report prepared for the Local Government Initiative of the Open Society Institute (LGI), within the program Local Government Policy Partnership Fiscal Decentralization Initiative in 2002; Author: Afrodita Popa

concept, the institutions and the priorities for regional development in the period 2000-2002 are also described here.

Chapter 4 presents an inventory of the funds allotted for capital investment in the 1999-2001, according to their source (The European Union, bilateral agreements, the State Budget and the Local Budgets, contributions from beneficiaries) and describes the flow of these funds.

Chapter 5 presents an analysis of the current system of financing capital investments based on the capacity of the local public administration, of the operators of public services to participate in the co-financing of these investments, and presents the main trends on capital investment financing in the period 2002-2005.

1.3 LIMITATIONS

This study does not intend to make a comparison of fund allocation for investment financing on a sectorial or regional basis, nor does it intend to analyze the efficiency of various approaches in the allocation of these funds.

The main objective of this study is to make an inventory of the funds allotted for capital investment financing in Romania in the period 1999 – 2000, and to provide all necessary information for a detailed analysis of the status of regional development in Romania in terms of capital investments. No detailed analysis will be made, therefore, of whether the funds allocated for capital investment financing in the period analyzed contributed to the decrease in intra-regional disparities, whether they stimulated the labor market development or economic growth, nor to what extent. Information in this study can however be the basis for such an analysis.

2. The Public Administration System In Romania

2.1 THE CENTRAL PUBLIC ADMINISTRATION

The institutions of the central public administration with an important role in the capital investment financing process in Romania are:

Ministry of Development and Prognosis (MDP) - a ministry of synthesis whose role is to draw up analyses and prognoses on the development of the Romanian economy, to implement the government strategy and programs, to promote the economic and social development policies, as well as foreign investments in Romania. MDP is made up of the former National Agency for Regional Development and the former General Directorate of Prognosis subordinate to the Ministry of Public Finance. In the MDP, there are two major directorates, Regional Development and Strategy and Prognosis. In the social and economic development field as a whole, with regard to development and regions of the country, the MDP has the following main functions:

- Draws up the draft National Development Plan; provides coordination of the implementation of the national development policy throughout the country, by regions and zones;
- Pursues attainment of the objectives of economic and social cohesion for the narrowing of the differences in development of regions and zones of the country;
- Analyzes the funding of the regional development programs and projects, draws up programs for support of the regions and makes proposals to the National Council for Regional Development;
- Draws up the criteria, priorities and procedures necessary for financing regional development programs and projects.

Ministry of Public Finance (MPF) - ministry with a role of coordination and synthesis. The General Directorate of Public Finance and State Financial Control (GDPFSFC) represents the MPF in every county.

Ministry of Public Works, Transport and Housing (MPWTH) represents the state authority in the field of railway, road, inland rivers, air transportation, multi-modal and combined constructions, and lay out of territory. It controls directly, by means of special technical bodies, subordinated public institutions, or authorized commercial companies. In this capacity, the main functions of the MPWTH (from the point of view of the current study) are the following:

- To issue instructions, norms and regulations that are compulsory for specific road, rail, naval and air activities;
- To establish binding general norms and technical norms for design, construction, repair and use of means of transportation for roads, highways, ports, airports, the railway, and subway lines and stations;
- To exercise state control over the observance of the status of building permits and over the consistent application of the provisions of the quality system in constructions, in all its stages and components;
- To collaborate with the county and local councils on the drafting of studies and programs of urban and rural development, for home building and related works, with a view to carrying out sectorial policies in these fields.

The *National Administration of Roads (NAR)* - operates under the coordination of MPWTH; a *regie autonome* that is responsible for the administration of national roads and bridges through seven subordinated regional directorates.

The Ministry of Public Administration (MPA) - a ministry that implements the Government's policy in public administration, the strategy for the development of public services of local interest, etc.

The Ministry of Labor and Social Solidarity (MLSS) - a ministry whose role is to provide and coordinate the application of Government strategy and polices in the field of labor, protection and social solidarity.

The Ministry of Tourism (MT) - drafts and applies, on the basis of the Government's Program, the policy in the field of tourism, as a domain of priority in the national economy. The Ministry of Tourism has the following main responsibilities from the point of view of the current study:

- Draws up the national strategy and policy in tourism;
- Coordinates the technical assistance programs granted by the European Union, the World Tourism Organization and other international bodies, as well as the European integration program for tourism;
- Establishes the orientation of the programs of research, development and public investments in tourism;
- Establishes and manages the Special Fund for the promotion and development of tourism made up of the contribution of the tourism companies and of the revenues obtained from the privatization of companies in the field of tourism, as well as other funds and revenues constituted according to the law;
- Coordinates together with the Ministry of Labor and Social Solidarity the national and county programs for professional conversion in the trades specific for tourism.

Other institutions with an important role in financing capital investments are:

The National Council for Regional Development (NCRD) - a deliberative body, without legal personality, whose main role is to promote the regional development policy in Romania.

Its main responsibilities are:

- To approve the national strategy and national program for regional development;
- To submit proposals for the establishment of the National Fund for Regional Development (NFRD) to the State;
- To approve the criteria, priorities and procedures for the allocation of funds from NFRD;
- To check the use of the funds earmarked for the Regional Development Agencies from NFRD, etc.

The NFRD is made up of 32 members, of whom 16 are representatives of the Regional Development Councils and 16 are representatives of the central administration. It is chaired by the Prime Minister.

The Ministry of Agriculture, Food and Forests (MAAF)
The Ministry of SMEs and Cooperation
The Ministry of Economy and Resources (MER)
The Ministry of Waters and Environment Protection (MWEP)
The Ministry of European Integration (MEI)

2.2 THE REGIONAL LEVEL

In conformity with Law nr.151/1998, On Regional Development, the voluntary association of counties and the Bucharest Municipality set up eight Development Regions. A Regional Development Council (RDC) was created in every Development Region, as a deliberative body and a Regional Development Agency (RDA), as an executive body.

The Regional Development Council (RDC)

RDC is a deliberative body whose role is to coordinate the activities and promote the objectives of the policy of regional development.

Every county is represented in the RDC (with a term in office of 4 years) by the County Council President, a representative of municipalities, a representative of towns and one of communes in the county.

The president and deputy-president of RDC are elected from among the members for a term of office of 1 year, by open ballot with a simple majority. These two functions cannot be filled simultaneously by the same county representatives.

RDCs represent the decision-making body for all the resolutions on regional development in their territories, setting out with the adoption of the Regional Development Plan.

The main answers of RDC are:

- To analyze and decide on the regional development strategy and programs;
- To approve the regional development projects;
- To approve the priorities, destination and criteria of allocation for the resources collected in the Regional development Fund;
- To control the use of the funds allocated to the Regional Development Agencies from the National Regional Development Fund;
- To control the observance of the regional objectives and to secure equal treatment for all the counties in the region by coordination of activity in the RDC.

The Regional Development Agency (RDA)

Every development region is led by a Regional Development Agency. Therefore, there are eight RDAs: RDA1 (North-East), RDA2 (South-East), RDA3 (South), RDA4 (South-West), RDA5 (West), RDA6 (North-West), RDA7 (Center) and RDA8 (Bucharest). The main responsibilities of RDAs are:

- Drafting and implementation of the regional development strategy and programs (with the prior review of RDC);
- Management of the regional development funds;
- Provision of technical assistance together with the local and county councils, as the case may be, for physical and legal persons with state capital in the underdeveloped zones;
- Drawing in of financial contributions to the Regional Development Fund and fund management in order to achieve the objectives established by the regional development programs.

2.3 THE LOCAL GOVERNMENTS

The basic structure of the local government in Romania is defined by the Constitution according to which, local self-government is achieved, "in the territorial administrative units …on the basis of the principle of local autonomy and decentralization of public services." These provisions, to which the Law on local government nr.215/2001 is added, allow for the organization of the local administration in sub-administrative divisions, from a geographical point of view. Currently, there are 41 counties in Romania, 260 municipalities and towns and 2,688 communes. Each administrative unit is a legal entity with all the rights and obligations deriving from the Romanian legislation in this respect. The geographical limits of the local councils cover practically the whole territory of the country. The limits of the county councils mingle with those of the local councils in their respective area.

There are two levels of the local self-governments in Romania. The first level is that of the county councils. The second level is that of the local councils (municipal, town or commune). Between the two levels of local government, there are no subordination relations. The operation of the local government in all the territorial administrative units is based on the following principles**:**

- Local public autonomy;
- Decentralization of local public services;
- Eligibility of the local public authority;
- Legality;
- Consultation of the citizens on local government issues of big interest.

The law does not establish a clear separation of the roles of each level. In principle, it is considered the role of the county councils is to coordinate the activity of the local councils without the latter being subordinated to the former. There is no single legislative regulation to establish the area of responsibility of the local government in Romania. For this reason, it is rather difficult to make a comprehensive inventory of all the responsibilities of the local governments. The main responsibilities of the local public administrations, regardless of their type are:

- Pre-school, primary and secondary education - maintenance expenditures, personnel expenditures, investment expenditures;
- Social security and protection (granting of the minimum wage, housing for the elderly, child protection, care for children with special needs etc), maintenance expenditures, personnel expenditures and investment expenditures;
- Housing;

- Public services of town management: drinking water and sewage (treatment, supply, collection), thermal energy in a central system, management of household waste, maintenance parks, green areas, cemeteries;
- Repair and rehabilitation of streets, communal roads, county roads, urban public transport, airport maintenance of a secondary interest (for the county councils);
- Environment protection;
- Cultural, sports, religious and spending leisure time activities;
- Civil defense;
- Other economic activities.

The policy of the local public administrations in the field of public services does not rely on coherent strategies, with clear priorities on a medium and long term. Most of the local public administrations do not have development strategies and neither do they have programs of concrete action meant to put them into practice. Priorities are quite dispersed and funds are insufficient to carry out investments necessary in the infrastructure simultaneously.

The situation of the whole infrastructure of public services is critical, that is why investments are necessary in every sector in order to maintain the respective service at a minimum level of operation.

The resources of the local budgets are limited and often uncertain which forces the local governments to establish short-term goals that more often than not tend to maintain services at a minimum level of operation.

In their turn, the Ministry of Public Works and Territory Layout, the Ministry of Transports, the Ministry of Industry, the Ministry of Public Administration do not have a clear policy on public services and the investments necessary for the infrastructure. It is absolutely necessary to have an articulated national program for a period of 10-20 years to establish the goals, priorities, and financing sources and to be correlated to the annual budgets[2].

This study-analysis will focus mainly on the investments of local governments in infrastructure: public services of town management, public transportation, communication means etc. As the situation differs according to the type of local administration (local council or county council), and the type of locality (rural or urban), a separate analysis will be further made of the responsibilities for infrastructure investments of every type of local administration.

The Responsibilities of the County Councils

The Romanian legislation does not make a clear-cut separation of the types of utilities provided by the local councils and by the county councils. That is why there is much redundancy, confusion and conflicts between the two levels of the local public administration. Usually, the county councils deal with the maintenance and modernization of the county roads and the regional water supply systems. On the other hand, the county councils coordinate the investments in infrastructure of any type by the local councils in rural areas, therefore, their influence in the field in big.

The Responsibilities of the Local Councils in the Urban Environment

[2] For the first time in 2002 such a program was drawn up. This is in the phase of a draft at the Ministry of Public Administration. The program should be adopted only after a real consultation of the local public administration and it should include measures to motivate them for attaining the established objectives.

In the urban localities, Romania focuses mostly on the infrastructure of services of utilities and town management, which implies more involvement from the local councils for this sector.

The situation of the small town should be analyzed separately from that of the towns with over 50,000 inhabitants. Until 1989, there was only one enterprise for town management at county level with different departments for the various towns of the county. After 1990, with the reform of the local government these economic structures were decentralized.

In the case of the towns of up to 50,000 inhabitants, the public utilities and town management services have usually been provided by entities that are directly under the authority of the local city hall - the so called ‘services in the town management administration’. They provide heating, drinking water supply, sewage treatment, maintenance and sanitation of the public roads, transports and storage of waste. In other cases, there is only one commercial company (or *regie*) that performs all these services. These localities have problems because, with few exceptions, they have been affected more by the transition to market economy and restructuring than the municipalities, especially the county seats. Their local budgets are extremely small. The population is affected by unemployment and poverty, incapable of paying their bills for utilities, which worsens the conditions of the local infrastructure even more. Most of these localities, in order to provide these services at a minimum level, are highly dependant on subsidies and equalization grants distributed by the county councils.

The localities of over 50,000 inhabitants and especially the municipalities that are county seats are better situated. The economy of these towns better resisted transition, a fact demonstrated once the local public finance law was enforced, when it was found that there are counties, where the municipality which is the county seat commands 70%-80% (sometimes even more) of the fiscal capacity of the county, for a population of 25 percent-40 percent of the total county.

These discrepancies explain the somewhat better situation of the quality of public services in the Romanian municipalities. The public resources of investments are much bigger (compared to the other localities in the county), and the bigger the investments, the more attractive they are to foreign investors (programs of EBRD, WB or PHARE, arrangements of a joint-venture type, etc).

The Responsibilities of the Local Councils In Rural areas

In rural areas, the local council administers common roads, public lighting and sanitation. Other services are rather rare in rural areas and are managed by means of some *regies* or commercial companies at the county level (systems for tapping, transporting and distributing the drinking water, treatment of sewage, district heating, household garbage collection and transportation, local transportation). A city hall in a rural area has very little staff, usually 7-8 people, generally with high school diplomas.

The main preoccupation of a city hall in rural areas is to persuade the county council to promote more important investment projects on its territory or to maintain and modernize the county roads and related bridges, gas or water supply networks (not sewage) - these are the main services and utilities that pre-occupy the local councils in rural areas.

The budgets of these communities are very small and in many cases do not cover even the operational expenditures of the city hall. For this reason, the local administrations in rural areass depend very much on the equalization grants distributed by the county council through criteria that are not very transparent.

2.4 THE RELATION OF LEVELS OF GOVERNMENT THROUGH CAPITAL INVESTMENT FINANCING FLOWS

The main financing sources in Romania now are[3]:

- PHARE, Economic and Social Cohesion, for the following areas:
  - Assistance for small and medium sized enterprises;
  - Technical and vocational education and training;
  - Social services;
  - Big infrastructure (regional);
  - Small infrastructure.
- ISPA, for the areas of:
  - Environment;
  - Transports.
- SAPARD;
- The World Bank Rural Development Program[4], for small rural infrastructure;
- Co-financing of Romania's Government;
- The Regional Development National Fund;
- Local government sources;
- Other sources coming from bilateral agreements.

According to the financing program, the relation between the central administration, the regional level and the beneficiary is different.

Thus, in the case of the capital investments through PHARE funds, the MDP is the Implementing Agency and Payment Agency and the RDAs are Implementing Agencies (except for the big infrastructure component for which the Implementing Authority is the NAR). MDP, as a Payment Agency is in direct contact with the beneficiaries.[5] Payments are made by the MDP to the beneficiaries' accounts at the County Treasuries.[6]

In the case of programs financed through ISPA, the ISPA National Coordinator is MEI and the coordinators for sectors are MWEP for the environment component and MPWTH for the transportation component. The Implementing Agencies for transportation are NAR (for roads) and National Company for Railways (for rail). The payment agency is the CFCU (Central Financing and Contracting Unit), within the MPF which makes the payments to the beneficiaries through the county.[7]

In the case of SAPARD, the Implementing Agency and the Payment Agency are in the MAAF. Payments to the beneficiaries are made through the County Treasuries.[8]

Co-financing from the Romanian Government for the PHARE program is in the quarterly transfer in the form of budget credits to the accounts of the treasury of MDP, which then makes transfers to the beneficiaries.

For the management of the NFRD, the 8 RDAs have been accredited as Payment Agencies, on the basis of frame contracts concluded for each program with MDP.

The investments financed from public resources of local administrations are directed by them, on the basis of budget credits, through the County Treasuries.

In the case of programs financed by bilateral agreements, Implementing procedures and the flow of investment funds are established at the signing of the agreement and differ from case to case.

[3] We will make reference only to those destined to capital investment financing as it comes out of the current study

[4] The program is in the phase of a pilot project, in 5 counties of the county; for this reason we will not refer extensively to it

[5] For more details on the institutional responsibilities, the Procedures of Implementation, selection, monitoring, control and reporting in the case of the PHARE programs - Economic and Social Cohesion, see Annex 1

[6] According to the legislation in force, all the payments from/to the public institutions are made through the Treasury. The local public administrations do not have the right to have accounts but in the treasury.

[7] For more details on the process of implementation and institutional relations as part of the ISPA financing programs, see Annex 2

[8] For more details on the Institutional relations and flow of projects in the case of Sapard, see Annex 3

3. REGIONAL DEVELOPMENT REGIONS

3.1 HISTORY, LEGAL FRAMEWORK

The concept of regional development was introduced in Romania in the project PHARE RO9408-SMEs and Regional Development. In component 1 of this program, Regional policies, a team of EU and Romanian experts (RAMBOLL Group) drafted a document entitled "Regional disparities in Romania in 1990 - 1994". This study was the basis of the GREEN CHARTER OF REGIONAL DEVELOPMENT edited in this program, in 1997. In 1997, the PHARE program had a component of institutional development which, with technical assistance support, contributed to the drafting of Law 151/1998 and laid the basis for creating the institutional frame for preparing Romania for the management of Structural Funds which this country will benefit from on becoming a EU member.

Thus the following bodies were created: the National Council for Regional Development, the National Agency for Regional Development, the development regions, the Regional development Councils and the Regional Development Agency.

By setting up the Ministry of Development and Prognosis, at the end of 2000, the former NARD was incorporated in this ministry.

Here are the present legal regulations for regional development:

- Law 151/1998, The Regional Development Law, modified by EGO 268/2000;
- GD no. 634/1998 for the approval of the methodological norms for the implementation of Law 151/1998 mentioning the organization and running of the RDCs;
- GD no. 16/2000, modified and completed by GD 340/2001, on the organization and operation of the Ministry of Development and Prognosis;
- GD no. 544/1999 for the approval of the rules of organization and operation of NCRD;
- GD 404/2001 for appointment of the NCRD members;
- GD 399/2001 on the zones of industrial restructuring with an economic development potential to which the funds in the PHARE 2001 program will be concentrated Economic and Social Cohesion and the adequate co-financing from the National Fund will be concentrated;
- GD 749/1999 on the drafting of the National Development Plan (NDP) for 2000-2002;
- Law 143/1999 on public social security ;
- Law 189/1998 on local public finance;
- Law 72/1996 on public finance;
- Law 213/1998 on public assets;
- GD 1011/1999 for the approval of the Memorandum of Understanding between the Government of Romania and the European Commission for the establishment of the National Fund;
- GO 63/1999 on the management regulations for the PHARE Funds for the investment component and of related co-financing from the state budget.

3.2 THE REGIONAL DEVELOPMENT CONCEPT

In the period 1998-1999, with PHARE assistance, a complex institutional framework was created which was meant to attain the regional development goals. These goals were provided in Law nr.151/1998 on regional development in Romania, with the observance of the principles and procedures according to which allocation and management of the Structural Funds is made in the EU Member States, in particular, the Regional Development European Fund.

The main goal of the regional development policy, as formulated in the Law is "the narrowing of the existing regional disparities, in particular by stimulating balanced development and accelerating the recovery of those zones that are lagging behind in development due to historic, geographic, economic and political circumstances and the prevention of new disparities and regional imbalances".

The institutional framework created in Law 151/1998 corresponds to the goals of the Program for Economic and Social Development of the Government and is in conformity with the norms and regulations of the European Union on Structural Funds and the Policy of economic and social cohesion.

If a comparison is made between the situation of Romania and that of the EU Member States or other countries with a market economy, one can see that the level of inter-regional disparities in the case of Romania is relatively low. All the regions, and within them, all the counties face special structural problems, both regarding quality and quantity.

This is also caused by the slow pace and difficulties of transition. Thus, by grouping some counties with different development problems in the same region, the process of establishing regions resulted in some regions with a relatively homogeneous development level. The only notable exceptions, representing two opposite poles of development, are the Bucharest-Ilfov regions, which is relatively developed in comparison to the others especially the North-East region, which is clearly the least developed.

Seen from a wider European perspective, the disparities in the level of revenues (as an indicator of the level of development disparities) are a phenomenon with profound economic and social implications. Thus, as the average GDP per capita in Romania is 22 percent of the European average, the Bucharest-Ilfov region attains only 38.5 percent of the European average (at a parity with the purchasing power) while the North Eastern region attains only 20 percent of the European average. In relative terms, this situation is similar with that of Greece, Portugal or Spain in the early nineties: a ratio of the disparities between the most developed region and the least developed region is about 180 percent and a small difference in percentage points as compared to the European average. Therefore, Romania has a difference of 18.0 points against the European average, while in Greece this difference was only 22.8 in the early nineties (at that time, the lowest difference in EU). It is important to note that besides the Bucharest-Ilfov and Northeastern regions, which are exceptions, all the other regions of Romania have similar average revenues, in the context of slightly higher development in the Western part of the country than in the Eastern part[9].

The current general development problems that exist in all the Development Regions of Romania are similar to European regions with lower development levels, where the structural policies under Goal 1 of the Structural Funds are applied. Thus, the whole country is eligible for the implementation of the structural funds specific for Goal 1. The zones with economic and social problems can be put in three big categories: zones that are traditionally underdeveloped, zones that pass through a severe industrial decline and zones with a fragile economic structure. In many respects, these categories are similar to those that in the European Union benefit from Goals 1 and 2 and to those that fall under the incidence of the Community Initiatives that aim the mono-industrial regions.

Each of the three types of zones of economic and social problems is found in almost all the Development Regions.

The restructuring of regional economies is an objective, which regions and administrative units are not capable of achieving alone. That is why, in addition to its primary goal of narrowing regional discrepancies, the national policy for regional development pursues prevention of the emergence of new disparities, due to the industrial decline of several zones of a country, helps with

9 Source: NDP 2002-2005

the restructuring of regional economies and their adjustment to the requirements of the market economy in the context of globalization.

3.3 POLICIES, PRIORITIES, NDP 2000-2002

The PHARE RO9807.01 sub-program, The Regional and Cohesion Policy, was a program for preparing and testing the institutional framework, its procedures and its capacity to absorb funds. The program was designed as an instrument, through which to prepare the technical and financial procedures necessary for the use of the PHARE, ISPA and SAPARD financial instruments of pre-accession for 2000.
In conformity with the Memorandum of financing, the investment projects had two domains:

- The component for industrial restructuring and development of human resources worth EUR15.5 million, with co-financing from the Romanian Government - The National Pre-Accession Fund of EUR 3,875 million;
- The component for rural development worth EUR 2.5 million and co-financing of EUR 0.625 million that was developed in partnership with the former NARD and the Ministry of Agriculture, Food and Forests.

The investment projects in the component of Industrial Restructuring and Development of Human Resources were implemented in all eight development regions, the initial allocation being equal. The selection method was an ‘Open call for proposals’. The selection was made at a regional level. For the projects in the portfolio, that is, those that got at least 65 points at the PHARE evaluation but for which there were no sufficient PHARE funds, NCRD approved financing from NFRD (100 percent state budget).

The projects had 3 goals: Local Initiatives, Tourism Development and Human Resources Development.

The grant contracts were signed by the former NARD. The Payment Agency was NARD, that is, the MDP. For acquisitions in these projects, the PHARE DIS Procedures were used and the Romanian regulations on procurement.

The selection procedures were transparent. The calls for proposals for the projects were advertised in the press. The information package was available on the Internet and at all RDAs. The press periodically informed the public about the number of projects and the value of the funds allotted, the criteria of allocation and the results of the calls for proposals were open in every Regional Development Agency.

In addition to these projects, three special projects were financed from the state budget, approved by government decision, allotted to the under developed areas. They were run also through the regional development institutional structures and their objectives were Business Development, Support for investment and Support for agricultural activity in rural areas.

In 1999 – 2000 the National Development Plan (NDP) was worked out and approved, with a financial planning for the period 2000-2002. The plan included the strategic development priorities for the period 2000-2002, for which Romania requires financial assistance from the EU (achieved through the PHARE, ISPA and SAPARD instruments), as well as the priorities that will be financed from internal resources and external resources, other than community ones. Romania's National Development Plan was drawn up in conformity with the National Program for Romania's Accession to the European Union (NPRA), with the provisions of Law nr. 151/1998 on regional development in Romania and with the EC Regulation nr. 1266/1999 on the coordination of financial assistance granted to the candidate states. The NDP was approved by the National Council for Regional Development and approved by Romania's Government, in conformity with the legal provisions in force.

This has been the first programming document drawn up on the conditions of a market economy. It is realized with both information coming from the field, by means of the Regional Development Plans worked out by the Regional Development Agencies, and with the plans and strategies worked out at a national level by various ministries and institutions involved in regional development.

The drafting of the National Development Plan was coordinated by the National Agency for Regional Development. This document was made in partnership with the eight agencies for Regional development, with the Ministries, government agencies and institutions and NGOs involved in regional development.

It should also be mentioned that the Ministry of Agriculture and Food, the Ministry of Transportation, as well as the Ministry of Waters, Forests and Environment Protection drew up their own programming documents for financial assistance, granted through the SAPARD and ISPA instruments. The Ministry of National Education together with the Ministry of Labor and Social Protection drew up the National Strategy for Human Resources Development.

The strategy of the National Development Plan for 2000 – 2002 relies on two priorities:

- The private sector development and investment promotion;
- Support for SMEs in the manufacturing field;

Improvement and Development of Regional and Local Infrastructure:

In spite of the fact that the infrastructure development projects are mainly the financing domain of ISPA, programs for minor infrastructure rehabilitation can be drawn up to facilitate correlation and harmonization of the projects financed through PHARE and ISPA. Intermingling of the two types of projects makes the achievement of the economic and social goals of these programs possible. Examples of such programs are:

1. Development and/or transformation of some buildings to be used by SMEs for starting the activity or as innovation centers;
2. Building of access roads to factories or warehouses;
3. Design of the water supply, sewage treatment and electricity networks; to draw investment for rehabilitating the public services infrastructure into regions;
4. Development of human resources;
5. Development of tourism;
6. Supporting research, technology development and innovation;
7. Development of agriculture in rural areas;
8. Development of transportation infrastructure;
9. Protection and improvement of the environment quality.

The first six are national priorities for regional development. The last three are national priorities for sectorial development.

The approach and philosophy of the nine priorities follows the requirements pinpointed in the National Program for Romania's Accession to the European Union closely.

The PHARE2000 program for regional development is the first program whose purpose is no longer the testing of created institutional framework and its fund-absorption capacity. Its purpose now is to support projects that will put into practice the principles that underlay the use of structural funds, and to consolidate the structures and procedures for the implementation of the funds, which Romania is operating in the pre-accession phase.

Under the PHARE2000 program, three out of the six development priorities listed in the NDP are being financed: human resources development in the context of industrial restructuring; support for SMEs in the field of manufacturing and services and improvement; and development of the regional and local infrastructure.

The PHARE2000 program operates with two concepts: "Priority Regions I" and "Priority Regions II". These are aimed at the adjustment and modeling of the principles of concentration of funds to the concrete conditions of Romania.

The amount allotted to Romania through the PHARE2000 program for Priority Regions I for projects listed among the three priorities of regional development is EUR 71 million. Added to this is national co-financing worth EUR 11.7 million. Financing from private sources is estimated at EUR12 million.

The Priority Regions II will be allotted EUR 13.3 million for financing projects for human resources development and development of SMEs. For financing of the other four priorities, (development of regional and local infrastructure, development of tourism, support for research and technological development, development of the private sector and promotion of investments), the amount of EUR 20 million will be allotted through the National Fund for Regional Development. Financing from private sources is estimated at EUR 9.85 million.

According to the established selection procedures, the projects drawn up in the Development Regions called Priority Regions I, (Northeast, Northwest, Southeast, South) will be financed. In order to benefit from financing, these projects should be part of the three priority projects established in the NDP.

The financing structure for the three development priorities will be: 25 percent (EUR 18 million) for the development of human resources, 25 percent (EUR 18 million) for supporting SMEs and 50 percent (EUR 35 million) for regional and local infrastructure projects. An additional Romanian co-financing of EUR 11.7 million is ear-marked for regional infrastructure.

National co-financing, that should have been added to the PHARE funds for projects of human resources development and support for SMEs will be allocated, according to the understanding with the European Commission, to the financing of Priority Regions II (South-West, West, Center and Bucharest-Ilfov) for projects on human resources and to support for development of SMEs. The amount allotted for every priority shall be EUR 6.65 million. The activities financed from funds representing national co-financing shall be implemented in the four regions of Priority One. The National Fund will provide co-financing and the mechanism of provision of funds to the Ministry of Development and Prognosis and for the development regions.

These regions will benefit also from an amount allotted from the state budget, through the National Fund for Regional Development worth EUR 20 million. It will be set aside for financing the other four priorities of development identified in the NDP. The purpose of the decision to finance all the priorities is to make it possible to initiate projects in varied domains while not restricting the options of regions regarding their own development directions.

Priority 1: Development of human resources in the context of industrial restructuring

(EUR 18 million -PHARE and EUR 6.65 million - state budget).

The objectives and the activities of this component are comply with the Strategy for Employment of the EU and with the priorities of the Social European Fund. In rural areas, the activities will be defined to support implementation of the SAPARD measures in the field of rural diversification (tourism, agro-food, SMEs). The horizontal measures identified in the NDP were grouped by three priorities:

Objective 1 - Training and re-training of the labor force in order to make it as flexible as possible to the dynamic needs of the labor force;

Objective 2 - Improvement of active measures for employment of the labor force as a systemic instrument for increasing employment;

Objective 3 - Promotion of social inclusion of underprivileged groups. This component is in implementation phase. The first open call for proposals was held in 2001.

Priority 2: Support for SMEs

(EUR 18 million - PHARE and EUR 6.65 million - state budget)

Objective 1 - Grants for the support of increasing investments for initiation of new enterprises and development of micro-enterprises, and of those recently established.

Generally, support through a grant will be limited to 50,000 euros for each individual grant. Every beneficiary should have matching funds of 40 percent of the total value of the eligible expenditures of the project. The projects should demonstrate the potential to produce a positive impact on the economy of the region where the activities will develop, consistent with the objectives and priorities of the Regional Development Plan and the Regional Development Strategy of the region. This component is presently being implemented. A call for proposals was held in 2001.

Objective 2 - Improvement of access of SMEs to medium- and long-term financing in order to make investments through a credit line. A credit line will be available for medium term loans for SMEs, together with a grant component accounting for up to 25 percent of the total PHARE allocation. The scheme will be implemented through a series of Romanian banks selection on a competitive basis.

The Romanian Implementation banks will be responsible for evaluation of the financing applications, of the payment applications and for monitoring the loan payment. The selection of banks is now underway.

Objective 3 - Improvement of access of SMEs to information, communication and services for the support of business, in order to increase competition, access to financing and opportunities offered by the market.

This component aims for the improvement of managerial skills, competitiveness and access to markets and information. It will focus on providing support services for SMEs, in four main domains:

- improvement of access of SMEs to the market opportunities;
- support for SMEs in certifying the technical and quality standards (ISO 9000);
- counseling of SMEs in order to obtain financing for investment, including starting new business; promotion of access of SMEs to information and communication.

The costs of eligibility and selection and the procedures will be specified with accuracy in the information package put at the disposal of the applicants free of charge, at the launch of the component this year.

Priority 3: The Local and Regional Infrastructure

(EUR 35 million – PHARE and EUR 11.7 million – state budget)

Investments in local and regional infrastructure are to focus on the creation of an attractive environment for enterprises on an internal and/or foreign market and the creation of permanent work places in regions. In this way, projects will be targeted to a complex necessity and will be targeted at various groups. This will have a regional impact, conforming with the objectives of economic and social cohesion.

The aggregate amount of the public aid related to this component is EUR 46.7 million to which the local contribution will be added. Every project will have a minimum EUR 2 million budget and the maximum PHARE financing for each project will be EUR 5 million. The projects that are to be financed in this component were selected by the RDA and took into account other potential projects or current projects financed from other sources, including ISPA and SAPARD and other national and international financing. Substantial co-financing from various sources and a solid agreement on this problem are necessary. Currently, these projects have tender documents for the selection of the suppliers (developers), documents that have been prepared according to the international standards with PHARE technical assistance. Early in 2002, the call for proposal procedures were launched for the contracts of work, in conformity with the procedures included in the PHARE-ISPA-SAPARD Practical Guide.

The identification, evaluation, selection and implementation of the infrastructure projects has been made by using the "pipe-line" mechanism: a list of potential eligible projects has been identified by a group including representatives of:

- the 4 RDAs of the 4 priority regions;
- the former NARD;
- the ministries responsible for the policy of transports, environment, industry and public works;
- the National Agency for Roads, the Ministry of European Integration;
- the Delegation of the European Commission in Romania.

To this project portfolio, projects of infrastructure for Priority Regions II were added. The projects have been proposed by the Regional Development Agencies and the County Local Councils and meet the local needs. Also worth mentioning, the beneficiaries of these projects can only be public institutions, for instance Ministries, Agencies, local governments, etc.

4. INVENTORY FOR CAPITAL INVESTMENT FINANCING

4.1 FUNDS FOR CAPITAL INVESTMENT FINANCING

Capital investments in Romania have four main sources:

External sources
- -The European Union (through the PHARE, ISPA, SAPARD instruments)
- -International financing through bilateral agreements (DFID, DEPA, etc.)

The state budget
- -Co-financing from the Romanian Government
- -The National Fund for Regional Development
- -Special targeted transfers to the local public administrations for investments financed partially from external loans
- -Funds from privatization for the special programs

The local budgets
- -Capital expenditures (own contribution for financing the contribution to certain projects or for creating the Regional Development Funds (RDF)
- -Loans (only for financing investments)

Funds from private beneficiaries in the form of the own contribution to projects

Specific structures are set up, similar to those that manage the structural funds in EU Member States. These structures are direct the European Commission for the development of the preaccession financial instruments. They are:

- Within the MPF, two structures called CFCU (Central Financing and Contracting Unit), in the role of a payment agency for the components of institutional development and for ISPA and the National Pre-Accession Fund; also responsible for programing and centralized management of the funds from the European Commission and of those representing cofinancing from the Romanian Government;
- MPF, with the role of an Implementing agency (technical and of payment) for the investment projects in the PHARE programs of Economic and Social Cohension;
- The SAPARD Agency within MAAF, acting as an Implementing agency (technical and payment) for the SAPARD Program.

Control of these funds is made through: outsourcing auditors (physical or legal persons), members of the Court of Auditors) complying with the Romanian legislation and the international agreements, the European Commission - DG Control, the Romanian Court of Audit, the European Court of Audit and specialized consulting companies, contracted by the funders.

4.2 THE FLOW OF FUNDS

4.2.1 Funding from External Sources

Funds from the European Union

PHARE: Funds are put in special accounts for each program in a commercial bank (ABN AMRO) which was selected by tender in 1999 at the creation of the National Pre-Accession Fund. The funds are transferable quarterly, on the basis of a Declaration of expenditures, in the sub-account of the MDP which is at the same bank. Monthly, after the centralization of the payment applications from the beneficiaries, the MDP exchanges the necessary amounts of euros into ROL and transfers them to the beneficiaries of the grant contracts. When external payments in hard currency are to be made, in order to avoid exchange rate losses, the MDP transfers the amounts in euros directly to the foreign service providers of goods and services/works, on the basis of contracts and invoices. This procedure was elaborated jointly with the NPF (National Pre-Accession Fund) and was approved by the European Commission.[10]

ISPA: Funds from the EC are put in the National Pre-Accession Fund from where they are transferred to CFCU. For environment programs, CFCU transfers these funds directly to the contractors. For transportation programs, CFCU transfers the funds to the Implementing Agency, which in its turn transfers them to the contractors of the jobs. Financial management is provided by the National Authorising Officer (NAO) who is secretary of state in the MPF[11].

SAPARD: The EC funds are transferred through the SAPARD Agency directly to the beneficiaries, through the county Treasuries[12]

International Financing through Bilateral Agreements

The amounts coming from other international financing programs or loans, are distributed according to the provisions of the respective international agreements. At a government level, they run through the special accounts of the MDP to the RDAs or directly to the beneficiaries, according to the procedures agreed upon with the funder. The RDAs can benefit from financing through bilateral agreements, at the level of the respective region, in which case the procedure is established in the financing agreement. [13]

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[10] See also Annex 1
[11] see also Annex 2
[12] see also Annex 3
[13] For instance, for the Rural Development Program of the north-east region, with financing from DFID, the funds are transferred from DFID to the consulting company that manages the program, from the latter to the RDA 1 north-east and from there to the beneficiaries.

Funds from the State Budget

Co-financing from the Romanian Government is included in the State Budget. Romania's obligations to participate in the financing of the PHARE projects of Economic and Social Cohesion, in compliance with the signed Financial Memorandums, are managed by the MPF, the National Pre-Accession Fund, and run through the state treasury. Application for these funds require the usual procedure of budget credits given by MPF. Granting of credits is made quarterly, with the creation of the PHARE funds. The National Pre-Accession Fund reports quarterly to the European Commission on how this obligation has been fulfilled, on which the release on a new tranche from PHARE depends. The amounts that are put in the account of the MDP at the treasury are transferred to the accounts of the beneficiaries (also in the treasury, according to GEO 120/31.08.1999). This procedure was established jointly with the National Fund and the Treasury Directorate in the MPF and was approved by the European Commission.

The National Fund for Regional Development

These funds are transfers from the state budget for regional development projects. Funds are transferred to the RDAs, which manage the programs for which these funds are allotted. The RDAs handle the transfers to the beneficiaries. These funds are run through the state treasury (county treasuries) through different accounts than those of the National Pre-Accession Fund. The structure and allocation of the funds are approved by Government Decisions. The procedures for the allocation are drawn up by the RDAs in cooperation with the MPF and CNDR. The programs approved for financing from these funds are published in the annexes to the Government Decisions.

Transfers with Special Destination for Investments Financed Partially from Foreign Loans

Funds targeted from the state budget are transferred to the local public administrations for the investment programs totally or partially financed from foreign loans. These funds have only the destination for which they have been allocated (targeted transfers). Not all local public administrations benefit from such funds, obviously, only those that can use external loans with a government guarantee.

Funds from Privatization for Special Programs

In compliance with government strategy and the priorities established by it, funds can be earmarked from the state budget for certain special programs considered priorities. These funds come from the state budget for privatization.

4.2.2 Funds from Local Budgets

Funds for Financing Capital Expenditures

The capital expenditures of the local administrations have the following financing sources:

- Current revenues including public revenues (local taxes and fees), the global income tax revenue share, mandates not funded from the state budget;
- Capital subsidies (part of targeted transfers) received in the form of grants from various central budgets, on the basis of projects;

- Investment credits – an infrequently used form at present.

Together with the annual budget, the local government approves an investment program (construction works or capital assets) that are to be carried out in the respective year. If financing only comes from current revenues of the local budgets, investment projects are included in the program, but only after technical-economic documentation (including rationale on necessity and opportunity) has been approved by the local/county councils. If investment projects are achieved with targeted transfers from the state budget, they are included in the investment program only after approval by the central government. The establishment of priorities in the distribution of funds falls to the local administration, especially the main credit holders (mayors or presidents of county councils).

In addition to public investment expenditures, the local public administrations contribute to the setting up of the Regional Development Funds (RDF), through which the regional-level projects, considered a priority, are financed.

Loans

Loans contracted by the local government are a less-frequently used possibility of financing investments in communal and public utilities services. Until 1999, local councils could only contract credits with the agreement of the government or parliament (included in special provisions in the annual budget law). After 1999, when Law 189/1998 on local public finance came into effect, local public administrations could contract credits on their own or could be guarantors for loans contracted by the *regie autonomes* or subordinate commercial companies (providing public services). Due to low fiscal capacity of the local public administrations and to restrictive legislative provisions (analysis not in the scope of the current study), loans are not a viable mode of financing investments at a local and county level.

4.3 Inventory of funds

Capital investments, in the current study, refer to investment funds for the following areas:

- Infrastructure;
- Promotion of economic activities;
- Development of human capital (only funds allotted for labor market stimulation)

For an inventory of the funds for capital investments in the period 1999-2000 to be made (this period is subject to the current study), a ‘virtual’ situation with the distribution of these funds per development region was made, for each of the two years analyzed, from these sources:

- The European Union
- The state budget
- Off budget sources
- Revenues to the local budgets
- Revenues from loans of the local government

The data analysis disclosed that it is impossible to draw up an annual “virtual chart” of the funds for financing capital investments, grouped according to the three types of investments and five sources defined above. Here are the reasons for this:

- Allocation of the capital investment funds by means of the pre-accession instruments (PHARE, ISPA, SAPARD[14]) is a process that covers several years starting with the call for proposals and ending with the effective allocation of the funds;

[14] No funds have been allocated to Romania from SAPARD when the study has been made

- The process of using the funds from the European Union, by means of the pre-accession instruments, is still new in Romania. Although the institutional framework and the fund allocation procedures were established, the effective allocation of the funds for projects started only in 2000-2001 and not for all the investment components presented in this study.
- The objective of the current study is an inventory of the funds for capital investment at national level and their distribution by regions, according to the classification defined above. With the absence of a more detailed analysis to include all the projects financed from EU funds, grouped by types, implementation stage, target area and beneficiaries, it is impossible to draw up the "virtual chart" planned initially.

Under these circumstances an inventory of the funds for capital investments was made separately according to the following sources:

- Capital investments of the local government(from own sources, loans, transfers for investments from the state budget, off budget sources) - Tables 1 and 2
- Capital investments from PHARE funds
- Capital investments from ISPA funds

Funds allocated from the state budget and those from off-budget sources were classified according to the receiver (funds for local government and funds representing co-financing from the Romanian Government through the PHARE and ISPA instruments).

In addition, a new category of funds has been introduced. Contributions of the beneficiaries of funds for capital investment which, although is not subject to the current study, are necessary information for future analyses in detail of capital investment financing.

The current study does not intend to make a quantitative analysis of the funds for capital investment financing, according to the allocation by components or source of the funds. A quantitative estimation, on the basis of the data summarized in tables 1-5 is far from realistic if it is done annually by the RDA. As mentioned above, the funds are transferred to the beneficiaries in ROL, in tranches, and possibly during several calendar years per project. The fact that EU funds are pledged in one year and disbursed one to two years later, makes these quantitative estimates on aggregate data less realistic due to the exchange rate changes.

4.3.1 Capital Investments of the Local Government

Tables 1 and 2 show funds allocated by the local governments for capital investment financing in 1999 and 2000, grouped by development regions. The columns referring to state budget and off-budget funds contain only the transfers for investments to the local government. Together with the column for the local government revenues and the local government revenues from loans, this represents the aggregate funds allocated for capital investment by the local government.

As the line budget of local public administrations does not allow for the separation of the funds for capital investment by the three categories that are the subject of this study, it is impossible to establish the amount destined for each category. For this reason, an approximation was made that all the investments of the local governments are destined for the three types of capital investments defined in this study, which is not altogether accurate.

The investments from state budget and off-budget funds in infrastructure are not confined only to tables 1 and 2 from the respective categories that exclusively represent transfers to local governments for investment.

The off-budget sources for financing investments of local governments refer to special funds of some line ministries that are managed by them off the state budget and to those managed by the Ministry of Public Finance.

In theory, each of the line ministries has a development plan in the field that it manages. However, these programs are not always related to the national strategy of regional development, to priorities established at a national and regional level and even less to elements related to the narrowing of inter or intra regional disparities, to articulated development of the infrastructure, regardless of their type.

In 1999, The Ministry of Transportation (MT) managed the "Special Road Fund" from which local governments, county councils or local councils (the latter through the county councils) were allocated funds on the basis of projects. The eligibility criteria for the selection of projects are not sufficiently transparent.

The Ministry of Public Works and Territory Rehabilitation (MPWTR) managed special funds for building houses for young people, for social housing, for the paving of roads and for water supply in rural areas. These funds were also run through the county council. In some cases, they were the final beneficiaries of the funds but in most cases, they were only the distributors of these funds to the local councils. The allocation was made on the basis of projects but in most cases without clear eligibility criteria for the projects.

In 2000 and 2001, other types of special funds were set up in the line ministries:

- The special fund for civilian aviation, managed by the MT and allocated to the county councils for covering the expenditures for the maintenance of airports of national importance on their territory
- The fund for the rehabilitation of the buildings with a high seismic risk, managed by MPWTR and allotted to the local councils
- The fund for the urgent finalization of the general urban plans, managed by MPWTR and allocated to the local councils (municipalities)

As of 2001, the MT and MPWTR merged into one ministry, the Ministry of Public Works, Transports and Housing which is responsible now for the management of these funds.

Table 1. LOCAL GOVERNMENT funds for capital investment financing, 1999[15]

Source of Funds	State Budget (EUR)	Off-Budget Sources (EUR)	LOCAL GOVERNMENT revenues for investments (EUR)	LOCAL GOVERNMENT revenues from loans (EUR)	Total (EUR)	Population	Total investment /capita (EUR)	LOCAL GOVERNMENT revenues for investment /capita (EUR)
Destination								
RDA 1 (NE)	6,070,744	18,399,915	14,131,062	622,575	39,224,297	3,786,066	10.36	3.90
RDA 2 (SE)	7,679,801	21,306,680	13,432,165	318,198	42,736,845	2,983,028	14.33	4.61
RDA 3 (S)	2,279,583	15,653,916	15,685,136	802,983	34,421,617	3,499,272	9.84	4.71
RDA 4 (SW)	1,070,259	11,511,275	10,504,971	216,659	23,303,164	2,423,059	9.62	4.42
RDA 5 (V)	3,562,682	13,363,240	5,072,017	203,080	22,201,018	2,068,149	10.73	2.55
RDA 6 (NW)	7,136,275	17,867,483	7,596,084	151,552	32,751,394	2,864,034	11.44	2.71
RDA 7 (C)	5,771,642	15,579,049	7,010,487	-	28,361,178	2,654,843	10.68	2.64
RDA 8 (B)	4,786,615	29,405,553	12,955,504	19,398,642	66,546,314	2,291,528	29.04	14.12
Total	38,357,602	143,087,112	86,387,427	21,713,688	289,545,829	22,569,979	12.83	4.79

Table 2: LOCAL GOVERNMENT funds for capital investment financing, 2000

Source of Funds	State Budget (EUR)	Off Budget Sources (EUR)	LOCAL GOVERNMENT revenues for investments (EUR)	LOCAL GOVERNMENT revenues from loans (EUR)	Total (EUR)	Population	Total investments /capita (EUR)	LOCAL GOVERNMENT revenues for investments /capita (EUR)
Destination								
RDA 1 (NE)	5,173,958	26,943,566	8,015,013	213,051	40,345,588	3,786,066	10.66	2.17
RDA 2 (SE)	7,771,788	23,446,316	21,371,897	364,663	52,954,665	2,983,028	17.75	7.29
RDA 3 (S)	4,825,348	22,661,250	13,310,162	6,788	40,803,548	3,499,272	11.66	3.81
RDA 4 (SW)	297,280	15,258,733	11,636,922	121,389	27,314,324	2,423,059	11.27	4.85
RDA 5 (V)	4,446,465	16,945,598	5,202,745	94,139	26,688,946	2,068,149	12.90	2.56
RDA 6 (NW)	7,684,487	23,352,128	5,278,403	11,544	36,326,562	2,864,034	12.68	1.85
RDA 7 (C)	3,073,874	20,704,553	5,633,900	19,819	29,432,146	2,654,843	11.09	2.13
RDA 8 (B)	6,939,801	25,224,000	45,984,541	49,547	78,197,889	2,291,528	34.12	20.09
Total	40,213,001	174,536,144	116,433,583	880,939	332,063,667	22,569,979	14.71	5.20

[15] Source: Ministry of Public Finance, the budget performance of the local governments in 1999 and 2000

2. Capital Investments from PHARE Funds

1999 was the year when the institutional bases were laid for the regional structures. Procedures were defined. RDAs got staff and equipment and an intense training program for the staff was held.

1999 was the year when the first call for proposals in the PHARE RO9807.01 program, ‘Economic and Social Cohesion’ was announced. Following the call for proposals, PHARE financing for the selected projects began to be allocated in 2001.

In general, the capital investment financing process through PHARE runs as follows:

- Year 1 – call for proposals, selection funds;
- Year 2 – allocation funds for projects;
- Year 3 – release of funds, by projects and in tranches, according to the contractual specifics for each project.

During a calendar year, it is possible that the funds effectively allocated for capital investments come from sources allocated in different years, as shown in tables 3 and 4.

Table 3 presents the sources for financing capital investments in 2000 and 2001, which come from the 1998 PHARE allocation, the National Fund for Regional Development in 1999 and 2000 and the special investment programs approved for financing in 2000 and 2001.

In 2000 and 2001, the funds allocated from PHARE were only for the components for the Promotion of Economic Activity and Human Capital Development. Promotion of Economic Activities referred to the Local Initiatives and Tourism. Additionally, three more grant schemes were financed from the State Budget: Business Development, Support for Investments and Support for Agricultural Activities. Only the first two were taken into consideration in the chapter "Promotion of Economic Activities".

Table 4 presents the financing sources allocated through PHARE 2000 and NFRD 2001. The funds from these sources will be allocated as of 2002.

When this study was made, the call for proposals for the "Human Resources" component was held. There are three priorities for this component: the first two refer to the labor market, the third to social integration. The funds are not broken down by priorities, so the related column of table 4 is the aggregate amount to be allotted. How much the first two priorities amount to (that is, the component "Human Capital Development") is not yet known because the fund allocation is not done by priorities but by aggregate "Human Resources" component.

Regarding the component Infrastructure and Economic Activity Promotion, the project selection is over and the call for proposals for the developer and supervisor is to be determined.

For the Economic Activity component, only the line of grants for newly set up SMEs was considered. For this, financing from public funds (the European Union and the State Budget) cannot exceed 60 percent of the contracts value. Added to this were the schemes of grants (with the NFRD financing source) approved in a Government Decision for RDA 1 and five other counties (Hunedoara, Alba, Tulcea, Giurgiu Caras-Severin).

Another financing scheme from the European Union destined for Promotion of Economic Activities, worth in total EUR 8.1 million, will be a credit line for SMEs. When this study was made, this financing scheme was in the process of selecting a bank.

Table 3: Funds 2000 - 2001, from allocation PHARE 1998, NFRD 1999 and 2000, Special Programs 1999 and 2000[16]

		PROMOTION of ECONOMIC ACTIVITIES (2)				HUMAN RESOURCES DEVELOPMENT (3)				Total investments /capita (EUR)
Source of Funds	Population	European Union (EUR)	State Budget (EUR)	Public Contributions Beneficiaries (EUR)	Total investments(2) /capita (EUR)	European Union (EUR)	State Budget (EUR)	Public Contributions Beneficiaries (EUR)	Total investments(3) /capita (EUR)	
Destination										
RDA 1 (NE)	3,786,066	1,600,427	6,921,535	2,984,307	3.04	392,931	98,233	108,353	0.16	3.20
RDA 2 (SE)	2,983,028	1,847,477	6,388,817	1,539,564	3.28	130,023	32,506	327,443	0.16	3.44
RDA 3 (S)	3,499,272	1,613,602	4,107,943	3,564,157	2.65	351,514	87,879	327,443	0.22	2.87
RDA 4 (SW)	2,423,059	1,510,694	8,193,406	2,857,408	5.18	434,966	108,741	327,443	0.36	5.54
RDA 5 (V)	2,068,149	1,720,492	5,275,705	3,548,772	5.10	261,761	65,440	327,443	0.32	5.42
RDA 6 (NV)	2,864,034	1,641,326	11,024,937	3,330,572	5.59	346,122	86,531	327,443	0.27	5.85
RDA 7 (C)	2,654,843	1,684,182	7,916,446	2,748,499	4.65	302,913	75,728	327,443	0.27	4.92
RDA 8 (B)	2,291,528	1,479,114	1,235,315	1,232,595	1.72	487,491	121,873	327,443	0.41	2.13
Total:	22,569,979	13,097,314	51,064,104	21,805,875	3.81	2,707,722	676,930	2,400,451	0.26	4.07

Table 4: Allocation PHARE 2000, NFRD 2001[17]

		INFRASTRUCTURE (1)				PROMOTION of ECONOMIC ACTIVITIES (2)			HUMAN RESOURCES DEVELOPMENT (3)			Total investments /capita (EUR)
Source of Funds	Population	European Union (EUR)	State Budget (EUR)	Public Contributions Beneficiaries (EUR)	Total investments(1) /capita (EUR)	European Union (EUR)	State Budget (EUR)	Total investments(2) /capita (EUR)	European Union (EUR)	State Budget (EUR)	Total investments(3) /capita (EUR)	
Destination												
RDA 1 (NE)	3,786,066	18,530,000	6,176,666	95,000	6.55	1,181,250	2,007,752	0.84	3,375,000	1,125,000	1.19	8.58
RDA 2 (SE)	2,983,028	12,950,000	4,316,666	1,475,335	6.28	1,181,250	1,111,084	0.77	3,375,000	1,125,000	1.51	8.56
RDA 3 (S)	3,499,272	10,900,000	3,633,333		4.15	1,181,250	1,111,084	0.66	3,375,000	1,125,000	1.29	6.09
RDA 4 (SW)	2,423,059				0	1,246,875	1,132,959	0.98	1,246,875	415,625	0.69	1.67
RDA 5 (V)	2,068,149	4,850,000	1,616,667		3.13	1,246,875	1,132,959	1.15	1,246,875	415,625	0.80	5.08
RDA 6 (NV)	2,864,034	10,607,258	3,535,752		4.94	1,181,250	1,111,084	0.80	3,375,000	1,125,000	1.57	7.31
RDA 7 (C)	2,654,843	4,500,000	1,500,000		2.26	1,246,875	1,132,959	0.90	1,246,875	415,625	0.63	3.78
RDA 8 (B)	2,291,528				0	1,246,875	415,625	0.73	1,246,875	415,625	0.73	1.45
Total	22,569,979	62,337,258	20,779,084	1,570,335	3.75	9,712,500	9,155,509	0.84	18,487,500	6,162,500	1.09	5.68

16 Source: Ministry of Development and Prognosis
17 Source:: Ministry of development and Prognosis

3. Capital Investment from ISPA Funds

Romania is to receive between 20 percent and 26 percent of the overall total of EUR 1,040 million per year available to ISPA over the period 2000 to 2006 (i.e., EUR 208 million to EUR 270 million per year). Romania is thus the second largest recipient after Poland. ISPA will finance infrastructure projects in the field of transportation and environment. Although the ISPA approach is a sectorial one, the flow of funds for capital investment will be taken into consideration in this study since their volume is very important.

Environment: drinking water supply, treatment of Wastewater, management of solid waste and hazardous waste, air pollution. The implementation of these directives is closely related to the improvement of the health and quality of life of citizens and has a direct positive impact on the economic and social cohesion.

Transport: Assistance will go to transport infrastructure projects which encourage sustainable forms of moving people and goods, in particular projects which are of EU interests, and also projects which enable Romania to meet the objectives of the Accession Partnerships.

Beneficiaries: Beneficiaries of the ISPA program can be local and central governments (Ministries in line, County Councils, Mayors Offices), *Regies Autonomes*, National Companies capable of developing big infrastructure projects like the National Administration of Roads and National Company for Railways.

Eligibility: ISPA will finance pre-identified projects. The ministries in line have to prepare a separate strategic paper for both environment and transport identifying the priorities for each sector. The proposed ISPA applications must be consistent with the ISPA Strategy adopted by the candidate countries and endorsed by the Commission.

These measures must be of high quality and of a sufficient scale to have a significant impact in the field of environmental protection or improved transport networks.

In order to obtain ISPA funds, the following steps are to be followed[18]:

- Beneficiaries must submit project proposals to the two Ministries in line (MWEP, MPWTH) for evaluation.
- Eligible applications are then submitted via MEI (central coordinating body in the Romanian Government and main contact point for the European Commission) to the European Commission, DG Regio, ISPA Unit. The role of MEI is to submit applications for assistance, organize monitoring committees, and arbitrate between Ministries
- The applications are examined by Commission services. Commission submits the acceptable projects for opinion to the ISPA Management Committee.
- After having received a positive review from the Management Committee, the European Commission adopts the project and submits a Financing Memorandum for signature to the beneficiary country.

Financial requirements: Projects submitted for approval under ISPA must have a minimum budget of 5 MEURO, out of which a maximum of 75 percent of public, or equivalent, expenditure (exceptionally up to 85 percent) can be covered by ISPA funds. The rest is to be provided by the beneficiary from central or local budgets, loans, donations, etc.

[18] See also Annex 2

Institutional arrangements:

Implementing Authority - line ministries for each sector. MPWTH and MWEP are the Implementing Authorities for the ISPA program. In each of these ministries, ISPA Coordination Units are established.
Implementing Agency – nominated with the responsibility to launch a call for tenders, to sign contracts and to follow up the implementation. Presently, the Commission has *ex-ante* control. For ongoing projects, Romania has three Implementing Agencies: one for environment (CFCU), and two for transportation (NAR and CFR, the National Railway Company).

Current status: In 2000, Romania submitted four applications to DG Regio for the transportation sector and seventeen applications for the environment sector to be analyzed by the Management Committee of the European Commission. The Committee approved twelve Romanian Applications (8 environmental projects and 4 transportation projects).

Romania has committed all of its projected funds for the year 2000 evenly between the environment and transportation with the Financing Memorandum signed on December 20, 2000.

The projects approved by the Management Committee in November 2000 (i.e., Arad, Braila and the road project for Craiova-Turnu Severin) are committed from the budget of 2001. Two Applications for Technical Assistance, one for environment and one for transport, were also approved in December 2000.

The Management Committee approved four new projects in July 2001, three in the field of Environment for the drinking water supply, wastewater treatment and sewage system in the cities of Oradea, Focsani and Brasov and one in the field of transportation for the construction of the motorway by-pass at Sibiu.

In October 2001, two new environmental measures were approved as follows: Wastewater and Sewage System Rehabilitation in Timisoara and Drinking and Wastewater System Rehabilitation in Targu Mures.

The total amount of the ISPA projects approved in 2000 and 2001 is EUR 1,214,456,373, out of which, the ISPA Grant is EUR 905,248,389[19].
The implementation of the ISPA projects started with the first three projects in the field of transport.
The first works for both the field of transportation and the environment started to go to contract in the second half of 2001.

[19] For more details see Table 5; In the totals mentioned is also included the Technical Assistance component, which is not detailed in Table 5

Table 5. Allocation ISPA, 2000 – 2001

ISPA Project Location		Description	Total Eligible Cost (EUR)	ISPA Grant (EUR)	%
ENVIRONMENT					
1	Piatra Neamt	Waste Management Program	13,846,000	10,374,000	74.9
2	Constanta	Wastewater Treatment Plant /sewage system	96,556,653	72,417,490	75.0
3	Iasi	Water and Wastewater System	51,378,000	38,533,500	75.0
4	Jiu Valley	Danutoni Wastewater Treatment Plant	9,680,000	7,260,000	75.0
5	Craiova	Sewage System & Wastewater Treatment Plant	70,378,000	52,783,500	75.0
6	Arad	Wastewater Treatment Plant	18,000,000	13,500,000	75.0
7	Braila	Wastewater Treatment Plant / Sewage System	59,877,400	44,908,050	75.0
8	Cluj	Wastewater Treatment Plant / Sewage System	46,755,800	35,066,850	75.0
9	Focsani	Wastewater Treatment Plant / Sewage System	15,876,500	11,748,610	74.0
10	Oradea	Wastewater Treatment Plant / Sewage System	23,906,000	16,734,200	70.0
11	Brasov	Drinking Water Supply and Wastewater Treatment	58,708,624	41,683,123	71.0
12	Timisoara	Wastewater Treatment Plant / Sewage System	48,080,000	34,136,800	71.0
13	Targu Mures	Drinking Water and Wastewater System Rehabilitation	27,909,400	20,932,050	75.0
	TOTAL ENVIRONMENT		540,952,377	400,078,173	73.9
TRANSPORTATION					
1	Bucharest-Constanta	Rail upgrading (Baneasa - Fetesti)	308,972,588	231,729,441	75.0
2	Bucharest - Giurgiu	Road upgrading	57,912,828	43,434,621	75.0
3	Bucharest-Cernavoda.	Motorway (Bucharest-Cernavoda)	95,616,000	71,712,000	75.0
4	Craiova-Turnu Severin	Road Upgrading	117,002,705	87,752,029	75.0
5	Sibiu	Motorway by-pass	90,521,000	67,890,750	75.0
	TOTAL TRANSPORTATION		670,025,121	502,518,841	75.0

5. MAJOR TRENDS IN CAPITAL INVESTMENT FINANCING

5.1 ANALYSIS OF THE CURRENT SYSTEM

As presented in the previous chapters, capital investments in Romania are financed both from internal sources (the state budget, the local budgets, off-budget sources) and from sources attracted by the pre-accession financial instruments (PHARE, ISPA).

The institutional framework for absorption of the structural funds has already been created, the personnel in these institutions benefited from intense training, the procedures for the fund allocation have been finalized, and as of 2000, the funds for capital investment financing from the European Union started to be effectively allocated.

The capital investment needs in Romania are extremely big, especially in infrastructure. The other two components of the capital investments that are subject of the current study (Promotion of Economic Activities and Human Capital Development) need substantial funds. However, the most acute problems are in infrastructure, which is insufficient, most of it being physically and morally worn out. For this reason, the problem of capital investment financing in Romania is extremely important.

The previous chapters presented the investment funds allocated in the past few years in all of the three components. As can be seen from the analysis of the volume of the funds, the smallest came from the public resources of the local administrations. It is worth mentioning, however, that related to the local budgets, the investment funds are not at all insignificant. In big municipalities, they have increased to 30% of the total expenditures and sometimes even more.

As all the pre-accession financial instruments require a substantial contribution from the beneficiary of the funds (in the infrastructure component) it is very important to analyze the possibility of financing capital investments (both at the level of the local public administrations and at that of the service operators), and naturally, the financial capacity of local public administrations that clearly show investment possibilities.

Analysis of the Current Possibility of Capital Investment Financing

At the Level of the Local Public Administrations

The most widespread ways of financing big investment projects by means of loans were the programs of EBRD, PHARE and the World Bank. All these programs were run with government guarantees and were mainly focused on *regie autonomes* providing utilities in the big municipalities.

Projects of EBRD and the EIB are being implemented to grant credits without sovereign guarantees to some municipalities. Other municipalities are trying to finance projects of infrastructure by contracting loans with low interest rates from the internal or external market, including by issuance of municipal bonds (Mangalia, Predeal). Unfortunately, there is a series of impediments for these local public administration projects:

- Large loans required by the investments are beyond local budget capabilities. For the most prosperous municipalities in Romania, the level of the local budget per capita does not exceed USD 100, whereas in the Czech Republic it reaches USD 500-700 and in Poland USD 300-500;
- Commercial banks are reluctant to grant loans to the local governments, asking for material guarantees that, in general, cannot be offered by the local or county councils because of the small size of the private domain. Generally speaking, banks have the tendency to analyze projects of the local administrations according to the criteria used for commercial companies, which makes the loans seem unattractive to them. Commercial banks do not have the staff trained in the field of local public finance;

- Local public administrations are reluctant to take loans, as they believe the interest rates are too high compared to budget revenues. In the past few years, with the exception of 1999, revenues of these budgets decreased in real terms, a phenomenon that deters development of the credit market for local administrations;
- Local administrations are not familiar with analysis of solutions for financing investments with a view to choosing the best solution. In fact, local administrations simultaneously finance several long-term investments that proceed very slowly. The benefits of quickly finalizing a very important investment are not generally considered when the timeliness of contracting a credit is analyzed. Local government is not used to establishing investment programs with clear priorities and well defined objectives;
- Incomplete legislation and especially the requirement for local governments to have accounts in commercial banks;
- Economic and legislative instability. The high inflation rate and the instability of the ROL are not elements that stimulate municipal crediting. These phenomena explain also the element of high risk of investments and foreign credits to Romania, which represent additional costs for the beneficiaries.

At the Level of Service Operators

The operators of public services, be they commercial companies, *regie autonomes*, have very limited financial possibilities, mainly caused by:

- Small profit rate (when there is a profit rate). Currently these services are not organized according to economic efficiency criteria but on the basis of social protection principles;
- Chain insolvency and the delay in the payment of bills, especially for the heating and drinking water. Because of this, not even funds resulting from depreciation of fixed assets can be mobilized. There are localities where the average period for the payment of the bills exceeds 200 days, which, at the inflation rate of 40 percent per annum means a depreciation of about 25 percent between the time when the invoice is issued and when it is paid. This insolvency has two causes: the impossibility of individualizing the costs of services per consumer (and implicitly the impossibility of stopping the provision of the respective services to consumers who do not pay) and the extensive costs of the services provided;
- Exaggerated production costs, generated by the bad technical condition of most of the networks and installations, the inefficiency of big centralized systems. A situation of monopoly characterizes most public services both at a central and at a local level. A paradoxical situation is thus being created when the price of these services, considered elements of social protection, becomes excessively large compared to the incomes of the population. For instance, the current prices of heating, hot water and drinking water services, in a winter month, per family of four with two average salaries, living in a three-room apartment, consume up to about 25 percent of their income. Add to this, the costs of electricity, telephone and other strictly necessary services and the percentage goes even higher (to thirty percent of the monthly income of an average family);
- The public property system in Romania - the process provided for by Law 213/1998 [20] has not yet been finalized. There is no final separation of public assets from private assets, most importantly, the public assets of local public administrations from that of the state. This heavily discourages foreign companies from initiating big investment projects of infrastructure;
- The big volume of investments necessary for the rehabilitation of networks, modernization and expansion of water treatment stations, modernization of substations, metering and building ecological landfills.

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[20] The Law on public property and its legal status

Analysis of the Financial Capacity of the Local Government

Analysis of the economic structure and the expenditures of types of local administration for 1999 shows very interesting data about the local governments investments.

The investment expenditures of the local administrations amounted to ROL 4,767,698 million (USD 297.96 million) which accounts for 22.11 percent of the total expenditures, distributed per types of communities and local administrations as follows:

County councils:	ROL 824,190 million	(USD 51.51 million)	17.29 percent
Municipalities:	ROL 2,839,007 million	(USD 177.44 million)	59.55 percent
Towns:	ROL 386,153 million	(USD 24.13 million)	8.1 percent
Communes	ROL 718,048 million	(USD 44.88 million)	15.06 percent

Mention should be made of the fact that the level of investment expenditures is pretty high, considering the economic environment in Romania. There are big disparities between the budget expenditures of the municipalities (towns of over 25,000 - 30,000 inhabitants) and those of communes. Thus, with 44.41 percent of the country's population, the municipalities cover 70.08 percent of the material expenditures of the local councils, 94.26 percent of the expenditures with subsidies and transfers, 72 percent of the capital expenditures. The expenditures per capita show this ever more clearly. Thus, the investment expenditures in USD per capita were the following in 1999:

- Municipalities: USD 17.7 /per capita;
- Towns: USD 10.1 /per capita;
- Communes: USD 4.4 /per capita.

The ratio between the capital expenditures per capita in municipalities and communes is 4 to 1, which reflects both the difference in financial capacity and the big distance between the quantity and quality of the public services provided and the existing infrastructure. There are several explanations for these phenomena:

- The process of fiscal decentralization favored the municipalities, especially the county seat, which concentrates the biggest part of the country's economy. There are cases where the municipality which is also the county seat, accounting for 25 to 30 percent of the county population, concentrates over 80 percent of the fiscal capacity and therefore, its viable economy;
- The subsidies and transfers per capita are very large in municipalities because they concentrate the biggest part of public services with subsidized prices on district heating and local transportation;
- The budgets of the localities in rural areas are very small, so that their main expenditure is that with the staff payment in order to maintain the local public services at a minimum level;
- The share of capital expenditures is constant in the local budgets: 23.2 percent of the total expenditures of the municipalities, 22.93 percent of the total expenditures of towns, and 20.28 percent of the expenditures of communes. It is surprising that municipalities that have the most substantial resources do not invest more of their own budgets, compared to other local governments On has to take into consideration the big share of subsidies and transfers, social protection expenditures in their budgets. Thus, the share of expenditures with subsidies exceeds clearly that of expenditures with investments (31.5 percent against 22.06 percent - or USD 25.3 per capita against USD 17.7 per capita). A more detailed analysis of municipalities shows, that investments and subsidies are in a reverse proportional ratio, which leads to a vicious circle. The municipal governments are hindered by the subsidies for heating and local transportation from investing more significantly in these domains, which leads to the degradation of the infrastructure, to the increase in material expenditures and, implicitly, in the level of subsidies. It is also noteworthy that these domains need urgent investment in large amounts;
- The relatively small share of targeted transfers for investments received by local government from the state: ROL 628,353 million (USD 39.7 million), which accounts only for 13.18 percent. It is true that in addition to these, there are the so-called *revenues with special destination* formed from

off-budget funds that are at the general disposal of the Ministry of Transports, Public Works and Housing and whose volume is important: approx. ROL 2,000 billion (USD 125 million). These sources are used prevailingly for investment in home building, water tapping in rural areas, and for the rehabilitation of local and county roads);

- The low level of loans for investments of the local governments in 1999: only ROL 362,648 million (USD 22.66 million). This situation is slowly changing for the better, especially in 2001, due to the economic growth, stabilizing of the banking-financial sector and a relative reduction in inflation. Also, there is growing interest from the local administrations in Romania for using this type of capital investment financing;
- There is no clear cut difference between level II (local council) responsibilities in local public administration and level I (county councils). This hinders joint efforts for providing higher quality public services and the necessary infrastructure investments. The main beneficiaries of the county council expenditures are rural localities, primarily because of their small budgets.

This analysis reflects the situation of local public administration in Romania in a period in which fiscal decentralization is in full swing. The new responsibilities of local government in this process, their lack of predictability, and their allocation of responsibilities (very often without the allocation of necessary sources of revenue) reflected a decrease in the funds that could be used for capital investment financing.

If a comparison is made on the basis of the data analyzed in section 4, of capital investment funds allocated by local government in the years 1999 and 2000 (including those coming from state budget transfers), this amount is less than the amount, which the local government will have to allot in the following period as co-financing for programs financed from structural funds.

However, it is difficult right now to analyze the impact of capital investments on local budgets. First, on the basis of the aggregate data analyzed in section 4, it is impossible to estimate what the impact will be on every local government. This is dependent on their resources and the projects, to which they contribute co-financing. The financial capacity of local administrations varies considerably and investments necessary are directly proportionate to financial capability.

On the other hand, fiscal decentralization is well advanced. There are only a few responsibilities still to be transferred to the local administrations. When this process is concluded, the expenditures of local public administrations will be predictable enough for them to draft realistic budgets that reflect their needs and possibilities. The funds for capital investments will gain both in predictability and volume.

The majority of local public administrations are fully aware of the pressing need for infrastructure investments in their area. They are fully determined to do everything possible for drawing in funds for investments. Therefore, it is likely that, even with major budget restrictions, they will be able to mobilize all the necessary funds for co-financing, in the event of benefiting investment programs financed with future pre-accession instruments.

5.2 Institutional, Legislative Changes, Policies, Priorities, the NDP (2002-2005)

The approach to drafting the NDP for 2002 –2005 has progressed compared to prior years. Understanding of the content and role of the NDP both evolved with the approach of the NDP for 2000-2002, following a deeper economic and social analysis made at a sectorial and regional level. These analyses led to the identification of *7 priority development axes*, around which all the objectives, measures, programs and projects that will contribute to achievement of these major priorities will be articulated in the period of the plan:

Axis1. - Development of the manufacturing and related services sector, strengthening of competitiveness of economic activities and promotion of the private sector.

Axis2. - Improvement and development of the infrastructure.

Axis 3. - Consolidation of human resources potential, of the capacity of the labor force to adjust to market requirements and improvement of the quality of social services.

Axis 4. - Support for agriculture and rural development.
Axis 5. - Protection and improvement of the quality of environment.
Axis 6. - Stimulation of scientific research and technological development, innovation, communication, IT and the creation of the information society.
Axis 7. - Improvement of the economic structure of the regions, support for regional balance and sustainable development.

Drafting of the NDP 2002 -2005 covered several stages of consultations, both with the ministries and with the Regional development Councils, through their executive bodies, the Regional Development Agencies (RDAs). For the first time, meetings were organized between the ministries and the Regional Development Councils through the RDAs, a first step being thus made towards the correlation of sectorial plans with the regional plans.

Sectorial and regional financial programming was made in close connection with the drafting of the 2002 State Budget and the budget orientations for 2003-2005. It includes objectives, measures and programs that contribute to the achievement of the priority national axes of development. Financing sources were also identified: the State Budget (including state guaranteed loans), EU Pre-Accession Funds; and private sector contributions to Romania's development programs. In this way, coherence is provided for programming of the PHARE, ISPA and SAPARD funds with national investment planning and with other economic policies and national actions.

The PHARE programming of investments in Economic and Social Cohesion is based on the NDP. Thus, five sectorial priorities have been identified for 2001, 2002, 2003, three of which are continuations of those in the 2000 programming:

- Assistance for SMEs;
- The scheme of social services investments;
- Big Regional Infrastructure projects;
- Small Local Infrastructure projects;
- The publicity campaign, selection, monitoring and evaluation.

In order to concentrate activities and resources (in agreement with the approach to concentration used in the Member States), the Government and the Regional Development Agencies have identified 11 priority target zones, in the territory of seven of the eight Development Regions. These Industrial Restructuring Zones have already been approved by Romania's Government (GD nr. 399/2001).

In 2001, the PHARE budget allocated to the Economic and Social Cohesion (ESC) is EUR 85 million. Coordinated by the MDP, this will be added to EUR 27.32 million in financing from Romania's Government.

At a national level, the MDP, as an Implementing Agency, will be responsible for coordination of the whole process, by means of the Coordination Committee.

Big Regional Infrastructure Projects: this measure represents the continuation of the portfolio initiated in 2000. The objectives are:

- The development of regional transportation infrastructure for improving access to economic zones and for strengthening the connection between economic poles and European corridors of transportation;
- The development of the infrastructure that supports development of the environment of business and tourism, in the sense of consolidating the competitiveness of the SMEs by better access to technology, services, market and information;
- Rehabilitation of degraded sites and protection of those that are degrading but have economic potential (industrial sites, enterprises closed down in highly-polluted urban areas, natural sites or zones with tourist potential), by granting more attention to remedying heavily contaminated industrial sites.

The eligibility criteria for all these projects are:

- Direct beneficiaries should be the public authorities, central or local governments or state institutions, that will be the owners of that infrastructure;
- Access to infrastructures created should be equal for all potential users; differentiated tariffs should be justified in the project;
- The infrastructure achieved should remain in the ownership of the public sector for at least 5 years; future privatization could be done only with the agreement of the European Commission Delegation;
- Co-financing from the state budget is binding for every project;
- The projects will have a minimum value of EUR 2 million and maximum financing from PHARE of EUR 5 million;
- Identification, evaluation, selection and implementation of projects will pursue the same procedures established in 2000.
- Eligible projects will be identified explicitly in Financing Memorandum. The RDAs have the most important role in identifying this type of projects. Comprehensive feasibility studies, including environmental impact evaluation will be carried out with the support of the PHARE 2000 program.
- Preliminary evaluation of infrastructure projects, achieved with the support of an inter-institutional working group, will take place in February 2002. Eligible beneficiaries will present feasibility studies until April 2002. The list of projects proposed for financing will be submitted for the approval of the National Council for Regional Development until the end of May.
- The National Council for Regional Development will approve final selection of projects. Priority will be given to projects from the 11 target zones. This mechanism called the "pine-line" mechanism follows the principle of fair competition and of maturity of projects and does not rely on an equal allocation of funds between development regions.

Small Projects of Local Infrastructure: The main objectives of this component are:

- Improvement of local infrastructure, through increase of the attractiveness of urban areas for private investment, rehabilitation of the urban environment and increase in the quality of life in the communities that suffer from industrial restructuring;
- Rehabilitation of historical and cultural heritage, for increasing tourist potential and the business environment in urban areas.

Preliminary allocation of PHARE support is up to 50 percent for each objective.

The small infrastructure projects support projects concerning:

- Rehabilitation and improvement of the local transportation infrastructure (modernization, rehabilitation, consolidation works), environment, healthcare and social infrastructure;
- Investment projects for the improvement of the quality of tourist infrastructure and increase of the diversity of tourist facilities(rehabilitation and preservation of cultural and historical establishments or public sites, museums and other public zones, organization of trips);

The direct beneficiaries should be the public authorities, public institutions or non-profit organizations (NGOs). They should make their own contribution of at least 10 percent to the project budget.

The Applicant's Guide should be submitted for the approval of the European Commission Delegation in Bucharest by April 2002. An open call for proposals will be held in May 2002. Deadline for the submittal of the financing applications is estimated to be September 2002.

The RDAs will launch an open call for proposals at a regional level. In every region, a regional selection committee, appointed by the RDC and assisted by observers from the European Commission Delegation and the MEI, will evaluate the projects. The list of selected projects will be approved by the RDC and endorsed by the European Commission Delegation. The evaluation report will be sent to the MDP and endorsed by the European Commission Delegation. The MDP will conclude a regional frame agreement with every RDA for the technical management of these projects. The grant contracts will be the responsibility of the RDAs and the MDP. The acquisition contracts will be the responsibility of the beneficiaries of grants and will observe the PHARE-ISPA-SAPARD practical guide.

Implementation procedures secure a transparent and competitive process of selection of the projects, a process that also includes a campaign of information and raising awareness. Similarly, these procedures provide complete financial control of infrastructure works, in addition to their monitoring and supervision. During and at the end of the program, information materials and brochures will be publicized by means of the publication and dissemination of guides. All these complementary activities will be financed from the investment component of Economic and Social Cohesion.

5.3 CONCLUSIONS

Analysis of structure, flows, procedures and criteria of allocation of funds for financing capital investments showed both positive and negative aspects as did the structures through which these funds pass. These aspects will be reviewed next:

Positive Aspects

- Implementation of programs financed through pre-accession instruments was initiated and achieved.
- RDA staff were trained in the implementation of development programs in conformity with European standards.
- RDAs represent an intermediary step towards institutionalization of the regional level of public administration.

Negative Aspects

- There have been very frequent modifications in the institutional system of regional development created according to Law 151/1998.
- The central administration was/is reticent to work with RDAs, especially due to the fact that they are defined by law as non-governmental bodies of public interest.
- Influence of county council presidents is exaggerated at the level of the RDCs, which has a negative influence on the activity of RDAs (functional budgets of RDAs’ main source of revenue is the transfers from county council budgets and for this reason the influence of the political factor is reflected in the activity of the RDAs)
- RDAs dealt practically only with the management/implementation of projects financed from PHARE funds and in 1999/2000 from the NFRD. RDCs and RDAs are not attracting other major financing sources.
- The development strategies established at a regional level do not consider local government budgets.
- There is no policy of active development at a regional level.
- There are no adequate internal procedures at the level of the RDC/RDA on incompatibilities, conflicts of interests, nor on the establishment of the commission for evaluation of projects in PHARE programs.
- There are no performance indicators on the activity of RDAs.

ANNEX 1 – PHARE
INSTITUTIONAL RESPONSIBILITIES

Economic and Social Cohesion 2001, Investment Component[21]

Code	Investment Components	Implementing Agency	Implementing Authorities	Steering Committee	Project Selection Mechanism
A.	Assistance to small and medium sized enterprises	MDP	RDAs	MDP, RDA, Ministry of SMEs and Cooperation (MoSMEC), Ministry of Labour and Social Solidarity (MoLSS), Ministry of Waters and Environment Protection (MWEP)	- local open calls - Regional Selection Committees including RDAs, representative of MoSMEC, independent evaluators; observers from MDP, MEI, EC Delegation
B.	Technical and Vocational Education and Training	MDP		MDP, RDAs, Ministry of Education & Research (MER), MoLSS	- Regional Consortia: RDAs, County school Inspectorates, County Committees for Social Partnership Development VET - Regional Consortia will select the schools and identify needs
C.	Social Services investment scheme	MDP	RDAs	MDP, RDAs, MoLSS, MER	- local open calls - Regional Selection Committees including RDAs, representative of MoLSS, independent evaluators,; observers from MDP, MEI, EC Delegation
D.	Regional/large-scale infrastructure	MDP	MDP National Administration of Roads (NAR) for national roads	MDP, RDAs, Ministry of Public Works, Transport and Dwellings (MPWTD), MWEP, Ministry of Tourism (MT)	- maturity and impact of projects appraised at regional level - list of projects approved by RDBs - final approval by NBRD based on RDB proposals
E.	Small-scale local infrastructure scheme	MDP	RDAs	MDP, RDAs, Ministry of Public Works, Transport and Dwellings (MPWTD), MWEP, Ministry of Tourism (MT)	- local open calls - Regional Selection Committees including RDAs, independent evaluators,; observers from MDP, MEI, EC Delegation

21 Source: Ministry of Development and Prognosis

ANNEX 1 – PHARE(cont'd)
IMPLEMENTATION PROCEDURES

PHARE Economic and Social Cohesion 2001, Investment Component

No.	PROGRAM CYCLE / Main activities	EC Delegation / National Fund (NF)	Ministry of Development and Prognosis (MDP)	Other Institutions at (inter)national/regional/local level	Regional Development Agencies (RDAs)	Beneficiaries
I. FRAMEWORK AGREEMENTS						
I.1	SMEs schemes (A), social services (C) and small-scale infrastructure (E)	Endorses	Negotiates and signs		Negotiate and signs as Implementing Authority	
I.2	Regional/large scale infrastructure (D) - Framework agreement with beneficiary for local contribution and PHARE + national budget	Endorses	Negotiate and signs as Contracting Authority			Negotiates and signs
I.3	TVET component (B) - Framework contract for schools rehabilitation - Framework contract for equipment supply	Endorses	Negotiate and signs as Contracting Authority	MER negotiates and signs as Implementing Authority	Negotiate and signs for monitoring works contracts	
II. LAUNCHING CALLS FOR PROPOSALS						
II.1.	Components A, C, E[22]					
II.1.1	Draw-up Guidelines for applicants	endorsed by EC Delegation	Prepare information package and guidelines for applicants	Contribute to the package	Consultation	
II.1.2.	Public launch of calls for proposals, information campaign		Press releases and organize information seminars		Press releases and organize information seminars in the region	As target groups are invited to information seminars
II.1.3.	Receiving applications				Receive and register applications	Submit applications to RDAs
II.1.4.	Appointment of Regional Evaluation Committee	Approved by EC Delegation and nominate own observer	Nominate observer and send to EC Delegation the whole composition of Regional Evaluation Committees	Nominate observer and send to MDP	Appoint Regional Evaluation Committee, submit to RDBs and send to MDP	

[22] For components B, D there are 'pipe-lines' of projects, identified by Educational Inspectorates (for A) and ADR/MDP (for D)

ANNEX 1 – PHARE(cont'd)
IMPLEMENTATION PROCEDURES(CONT'D)

PHARE Economic and Social Cohesion 2001, Investment Component

No.	PROGRAM CYCLE / Main activities	EC Delegation / National Fund (NF)	Ministry of Development and Prognosis (MDP)	Other Institutions at (inter)national/regional/local level	Regional Development Agencies (RDAs)	Beneficiaries
III. APPRAISAL AND SELECTION OF PROJECTS						
III.1	Components A, C, E					
III.1.1	Appraisal and selection of projects	EC Delegation endorses list of selected projects	Observer and checks the Evaluation Reports from RDAs	Observers in the Regional Evaluation Committees	Organize the process, prepare Evaluation Reports and send to MDP	
IV. REGIONAL PROJECTS CONTRACTING						
IV.1.	Grant contract for components A, C, E		Signs as Contracting Authority		Prepare contract and signs as Implementing Authority	Signs
IV.2.	Works contract for D component	endorsed by EC Del.	Prepare tender documentation and launch tenders Negotiate and signs as Contracting Authority	Constructor offer Negotiate and signs		Contribute to tender documentation
IV.3.	Contracts for TVET component B - Works contract for schools - Equipment supply	endorsed by EC Del.	Negotiate and signs as Contracting Authority	Constructor negotiates and signs Supplier negotiates and signs		School Insp. preparation of technical specifications

ANNEX 1 – PHARE(cont'd)
IMPLEMENTATION PROCEDURES(CONT'D)

PHARE Economic and Social Cohesion 2001, Investment Component

No.	PROGRAM CYCLE / Main activities	Ministry of Development and Prognosis (MDP)	Regional Development Agencies (RDAs)	Beneficiaries
V. FINANCIAL MONITORING, PAYMENTS AND FINANCIAL CONTROL				
V.1.	Processing Grant Payment Claims and Reports	Receives all documents from RDAs Monitoring Department reviews. If passed, Monitoring Department approves the payment and sends all documents to Paying Directorate; if not, asks RDAs for more information. Paying Directorate will review eligible expenses for each budget line if passed, will issue two Orders for Payment: -one for ABN AMRO Bank (PHARE funds) -and one for Treasury (co-financing). If not passed, sends comments to RDAs/beneficiary, asking for more information.	RDAs register, check and endorse the Payment Claims and reports, complete a Checklist for each Claim and send them to MDP	Payment Claim together with technical and financial report send to RDAs
V.2.	Financial Control	Orders for Payment (OP) issued by the Paying Directorate are signed by the following persons: - SAO (Senior Accounting Officer); - Own Preventive Financial Control: checks again the justifying documents; - Delegate Preventive Financial Control: checks again the justifying documents; - PAO (Program Authorizing Officer). OPs are delivered to ABN AMRO Bank and Treasury by authorized persons in the Paying Directorate.		
V.3.	Reporting Activity	Signed contracts, Addendum and payments from PHARE funds are registered in PERSEUS reporting system by Paying Directorate. A PERSEUS report is sent to Brussels, EC Delegation and National Fund by 10th of each month. Monthly Reports and Requests of Funds are made by the Paying Directorate and sent to the National Fund. The Request is also signed by own preventive financial control. All payments are also registered in accordance with the Romanian accounting legislation.		

EC Delegation / National Fund (NF) and Other Institutions at (inter)national/regional/local level not applicable in this phase of the Annex

ANNEX 1 – PHARE(cont'd)
IMPLEMENTATION PROCEDURES(CONT'D)

PHARE Economic and Social Cohesion 2001, Investment Component

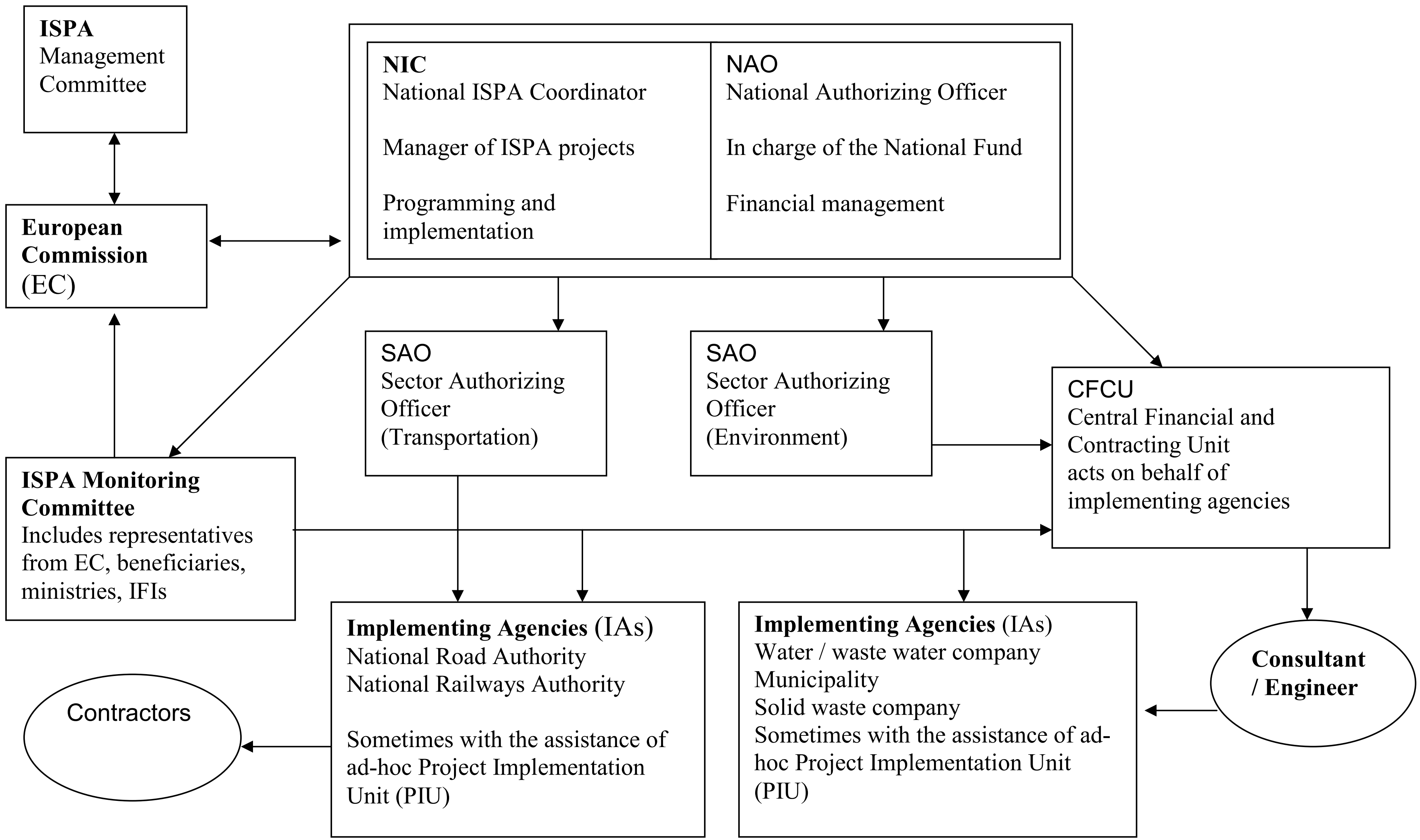
No.	PROGRAM CYCLE / Main activities	EC Delegation /National Fund (NF)	Ministry of Development and Prognosis (MDP)	Other Institutions at (inter)national/regional/local level	Regional Development Agencies (RDAs)	Beneficiaries
VI. TECHNICAL MONITORING, REPORTING AND CONTROL OF PROJECT IMPLEMENTATION						
VI.1.	Components A, C, E					
VI.1.1.	Financial and technical reports	Endorses templates for technical and financial reports	Designs financial and technical report templates Approves reports and sends to paying department		- receive reports from beneficiaries, checks and endorses, and then submit to MDP - prepare quarterly progress reports and submit to MDP	- fill in questionnaires and submit to RDAs (initial, interim and final)
VI.1.2.	Telephone inquiries and dispatch of questionnaires		Prepares the monitoring grid		Prepare and send questionnaires to beneficiaries according to monitoring grid Process data for monitoring and reporting	- fill in questionnaires send by RDAs and MDP
VI.1.3.	Monitoring visits and reporting back	Endorses template for visit report	Designs the visit report format Receives visits and reports from RDAs and Approves control of sample of projects (5%). Prepares reports after each visit and takes corrective actions		Undertake monitoring visits at least once during the contract period and also before final payment Write reports on each visit using for endorsement of technical and financial reports, and send to MDP	Provide all necessary support and information for the visit
VI.1.4.	Monitoring project procurement (according to Practical Guide for PHARE)		Ex-post control for a sample of 5%		Ex-post control	Prepare documentation for tenders, tendering and contracting

ANNEX 1 – PHARE(cont'd)
IMPLEMENTATION PROCEDURES(CONT'D)

PHARE Economic and Social Cohesion 2001, Investment Component

No.	PROGRAM CYCLE / Main activities	Ministry of Development and Prognosis (MDP)	Other Institutions at (inter)national/regional/local level	Regional Development Agencies (RDAs)	Beneficiaries
VI.2.	TVET component (B)				
VI.2.1.	Financial and technical reports	Designs financial and technical reports Approves reports and sends to paying department	Contractor for site supervision of *works* prepare reports and send to RDAs and School Inspectorates / Schools *Equipment:* MER receives reports from schools, checks and endorses, and submits to MDP - prepare quarterly progress reports and submit to MDP	- receive reports from specialist supervisor, checks and after beneficiary endorsement endorses, and submit to MDP (works) - prepare quarterly progress reports and submit to MDP	School Inspectorates / School receives reports and endorse, and then submit to RDAs (works) School endorse reports for equipment supply (from supplier) and submit to MER
VI.2.2.	Monitoring/control visits and reporting back	Designs the visit report format Controls a sample of projects (5%). Prepares reports after each visit and takes corrective actions	*Equipment:* MER Undertake monitoring visits at least before final payment Write reports on each visit and endorse final payment and send to MDP	*Works:* Undertake monitoring visits at least before final payment Write reports on each visit and endorse final payment and send to MDP	Schools provide all necessary support and information for the visit
VI.3.	Regional/Large-scale infrastructure (D)				
VI.3.1.	Financial and technical reports	Design financial and technical reports Approves reports and send to paying department	Contractor for site supervision of *works* prepare reports and send to beneficiaries, RDAs and NAR for national roads	- receives reports from specialist supervisor, checks and after beneficiary/NAR endorsement, endorses and submit to MDP - prepare quarterly progress reports and submit to MDP	Beneficiary and NAR receives reports and endorse, then submit to RDAs
VI.3.2.	Monitoring/control visits and reporting back	Design the visit report format Control a sample of projects (5%). Prepare reports after each visit and take corrective actions	Contractor for site supervision provide all necessary support and information	Undertake monitoring visits at least before final payment Write reports on each visit and endorse final payment and send to MDP	Provide all necessary support and information for the visit
VII.	EX-POST EVALUATION AND CONTROL				
VII.1.	Ex-post evaluation and control	Prepare quarterly and final evaluation report		Provide full support to MDP in gathering all the information	Provide full access to project files and records

ANNEX 2 - ISPA[23]



[23] Source: ISPA Manual

ANNEX 3 – SAPARD[24]

INSTITUTIONAL RELATIONS

The SAPARD Agency (set up within MAAF) is an implementation agency and a payment agency
MAAF and MPWTH carry out control for:
Establishment of the eligibility of beneficiaries
Establishment of eligibility of the project
The Ministry of European Integration is the management authority - monitors the SAPARD Agency and reports to the European Commission
The Ministry of Public Finance runs the funds, by means of the county treasuries

FLOW OF PROJECTS

Flow of the funding application

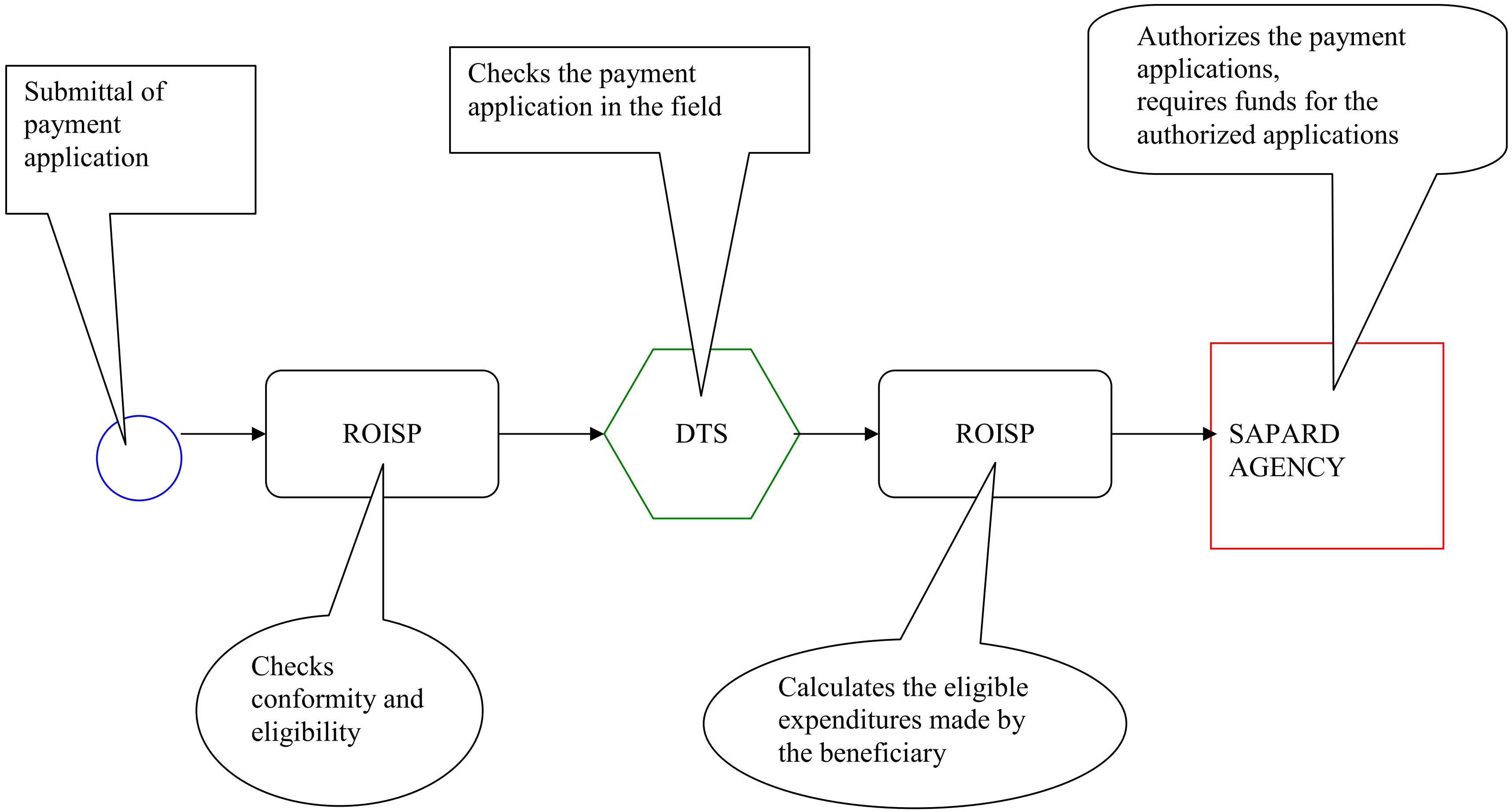
Submittal of application forms (together with the necessary documentation) is made at the Regional Offices for the Implementation of the SAPARD - ROISP program; the SAPARD Agency has 8 ROISP in its composition, a ROISP for every development region;
ROISP – checks the funding application in point of conformity and eligibility;
The Delegated Technical Service (DTS) (the representative in the territory of MAAF, or of MPWTH, The General Directorate for Agriculture and Food, the SAPARD Office in MPWTH) check in the field the validity of those declared by the beneficiary in the submitted funding form;
ROISP – receives the forms checked by DTS, evaluates them and sends them to the SAPARD Agency for re-checking
The SAPARD Agency– draws up and concludes the financing contracts with the beneficiaries

The flow of the payment applications

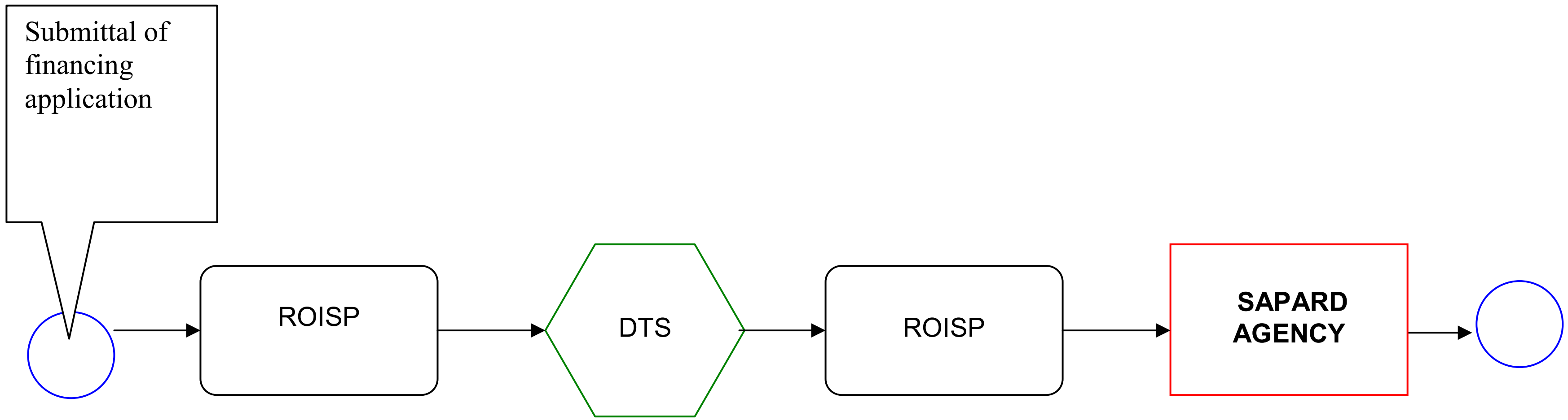
1. **Submittal of the payment application** (together with the necessary documentation) is made at ROISP
2. **ROISP** checks the payment application in point of conformity and eligibility;
3. **DTS** checks in the field the eligibility of expenditures made by the beneficiary and declared in the payment application;
4. **ROISP** receives the applications checked by DTS and calculates the amount (eligible) that should be paid to the beneficiary
5. **The SAPARD Agency** receives the payment applications from ROISP, and checks them again, checks the beneficiary's debit, requires funds from MPF for the amounts authorized to be paid, makes the payments and registers them in the accounts

[24] Source: SAPARD Agency

THE FINANCING APPLICATION



THE PAYMENT APPLICATION



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