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PAPER

The Importance of EU Cohesion Policy in Central and Eastern Europe

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Abstract The successful operation of EU level regional development – or cohesion – policy has a strategic importance from the point of view of the whole integration process. Strengthening economic, social and territorial cohesion and decreasing disparities between EU member states and regions are not only one of the main priorities of the integration, but at the same time these are justified expectations of the people living in the member states of the union. The cohesion policy transfers should be spent on those factors which have the biggest contribution to the improvement of development prospects and competitiveness in the given regions. After a decade of the "Eastern enlargement" it is important to have a look at the experiences of the new member states in relation to EU transfers and their effects on convergence. This article focuses on the impacts of cohesion policy transfers on catching up and the experience of the new member states. In the first part of the study the main reasons in favour of an intervention at EU level will be explained. After the theoretical background, the next part will present the importance of EU funds in financing public investments in Central and Eastern Europe. The last part will focus on the effects of EU regional policy on catching up: macro-econometric model results will be analysed and the "qualitative" effects of EU level regulatory frameworks will be explained. The main goal is to give an explanation about the "added value" of EU cohesion policy in the process of catching up in Central and Eastern European member states.

Keywords EU cohesion policy - Convergence - Catching up - New member states

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Introduction

All countries from Central and Eastern Europe joined the EU with a per capita GDP below the EU average (around 50 per cent of the old EU15 average) and even below the least developed old member states. However, GDP per capita at purchasing power parity of some new members (Slovenia, Czech Republic) was close to that of some old member states. The number of applicant countries and the differences between them were greater than ever before, and it was clear that they will all be net recipients of the EU common budget. An effective cohesion policy and European solidarity had to become more important than ever in achieving the major goal of reducing disparities in levels of development explicitly set by the EU founding treaty.

The new members wanted to get access to the Structural and Cohesion Funds as major instruments to support their modernisation process. Although future resource transfer was not the only reason to become a full member of the EU, this field played a very important role for the Central and Eastern European countries (CEECs). There is no doubt that it was of high importance for the historically undercapitalised countries to accelerate their modernisation process, among others, also by having access to EU funds. It should be emphasized that EU regional policy support is, of course, only part of the explanation for these processes, several other factors (increasing openness to the world economy, integration into the single market of the EU, national economic policies and the structural adaptation of the national economies) have also contributed to the catching up processes. At the same time, subsidies from the EU could play a decisive role in improving economic performance and convergence.

1. Theoretical Considerations about Convergence and Regional Transfers

Because of decreasing returns, in the neo-classical growth theories real convergence is expected. The marginal productivity of capital falls with accumulation, in turn reducing the incentive to save. As a result, growth slows down in richer countries and regions and the initially poorer countries will grow faster and converge. Divergence can be explained by endogenous growth model based on increasing returns of human capital and innovation; by the new economic geography based on the economics of agglomeration; and by institutionally oriented economic theories including social capital (Pelkmans, 2006. pp. 339-342).

Among the factors determining regional inequalities, differences in infrastructure and human resources largely contribute to the competitiveness of individual regions. The historically low level of infrastructural investment has undoubtedly hindered the improvement of productivity and employment levels in the least developed member

states of the EU. The infrastructural background, the quality of human resources, the levels attained in research and development activities, and, as a consequence of all the above, the region's ability to attract investments, are all factors determining competitiveness, which clearly reflect the development level and prospects of a region (Kengyel, 2008).

The new way of approaches based on the endogenous growth model tries to employ measures that enhance domestic capacity and capability to improve competitiveness. According to this model endogenously created improvements in the level of technological knowledge or in human capital generation and accumulation present the driving force of the long-term development and growth (Romer, 1990). Thus, the endogenous approach highlights the resources of the region, such as human capital, entrepreneurship, innovation, capacity to adopt new technologies, leadership and institutional capability, as well as trust based local relations as fundamental drivers of regional growth. Actually, these are the factors which increase the resource endowments and knowledge base of a region (Stimson, 2009).

The endogenous model argues that technological progress and human resources are the main factors in increasing the standard of living. The dynamics of development is not equal in different regions, because it depends on the qualification of human resources and additionally, the rate of human and physical capital involved in research and development activities, and efficiency in adopting new technologies. Accordingly, by investing in R&D activities and education, the region has ability to catch up with the developed regions or those that are technologically advanced and so, it will easily adopt the new technologies and innovations. In this context institutional system has a crucial role in moving the region up to the technology frontier considering that the utilization of the local resources depends on the institutional development and capability.

The new concept makes shift from the comparative and competitive advantage to collaborative advantage of the region. Along with the rising role of the endogenous growth model in the last decades, collaborative advantage was in the focus with an aim to support the partnership and cooperation between the different local agents: governmental institutions, private sector, educational institutions, NGOs. The good strategic planning and policy programming require the input from local agents. Indeed, the regional "assets" are underlined as the source of development. Competitive growth needs to be based on the endogenous model supporting not only the tangible infrastructure, but also the "soft" or less tangible factors. Furthermore, the collective approach including cooperation and partnership between all stakeholders in the region needs to be strongly supported.

Hence, efficiency of the whole institutional system is relevant, however when speaking about growth, institutions and networks that assist knowledge creation –

R&D, cooperation between the public, private and research sector, SMEs support and access to finance – are vital and therefore called ”systems of innovation” (Lundvall, 1992; Nelson, 1993). Experience suggests that there is a low growth in the regions where ineffective institutions operate and especially, if the learning process is not supported in these regions. This makes a clearer understanding of how processes such as physical and human capital accumulation, innovation, knowledge impact long run economic growth.

Wintjes and Hollanders (2011) emphasize that regional diversity and pathways and models of innovation calls for differentiated policies. In many regions, new technologies originate outside the region, innovation should therefore be considered in a broader sense, beyond the research- or science-based approach. Non-technological innovations (organisational and marketing processes, new forms of collaborative arrangements) also should be taken into account. Farole et al. (2011) stress that combating underdevelopment to enhance growth requires a mixture of multi-level governance and true subsidiarity. They call attention on the existence of technological and other types of frontiers which need a highly tailored set of interventions that are designed to address specific regional contexts of underdevelopment and to promote growth.

2. Necessity and Importance of an EU Level Regional Development Policy

The commitment to reduce economic disparities within the European Union has strengthened as the number of EU member states has grown and as integration has deepened, since both processes have resulted in an increase in regional problems. An effective regional policy is crucial to the development of an integrated EU. If the EU does not have a commitment to reduce the disparities in income differences and living standards, the future of the integrative process would be undermined. It would be unacceptable for citizens in differing parts of the Union to be subject to significantly different standards. The most important argument in favour of an EU policy is the necessity to have an active device by which the welfare benefits of economic integration are spread throughout the European Union. There is no guarantee that this will occur if market forces are allowed to operate freely. Evidence would suggest that the opposite effect might result and that development would become even more concentrated in the centre of the EU. It is, however, unrealistic to attempt to equalise all conditions throughout the EU, which are the result of different resource endowments and historical factors.

The EU’s regional policy has to improve the conditions that influence competitiveness in such a way that the given region becomes more attractive to investors, the spirit of enterprise is stimulated, and, as a result, economic growth takes off. It should be emphasized that “domestic factors – such as strong

development of a financial sector, prudent macroeconomic policy, strengthened institutional frameworks, improved public and corporate governance – correlate with external capital inflows. Depending on causality, these factors are considered either as conditions/thresholds needed to achieve growth benefits or as additional benefits/collaterals to growth." (Wilczynski, 2011. p. 5.)

In order to achieve these objectives, financial assistance is made available, through Structural and Cohesion Funds, for regions in need. EU funds aim to promote a better economic and social balance across the European Union and to reduce regional disparities, by co-financing with member states development actions in their regions. After the subsidies spent on the common agricultural policy, expenditure on cohesion policy is the most significant part of the EU budget and accounts for about one third of total EU common budget. The nature and distribution of the support has become a politically sensitive issue within the EU. For some states, in which the poorest regions are located, payments have come to be considered as the means to ensure their national government's support for potentially damaging EU actions. For other states, which are net contributors to the EU budget, payments from the Structural Funds are seen as a way of "clawing back" some of those contributions.

Cohesion policy has much to tell about how a more competitive EU can be achieved. Competitiveness, more jobs, growth, innovation and a balanced development of the EU's territory are not only at the heart of the Europe 2020 Strategy but also the major concern of European citizens. Cohesion instruments contribute to the endogenous growth potential of regions, to investments in human capital and physical infrastructure (transport and energy), to telecommunications and information technology infrastructure, and to research and innovation activities. This is not about charity, but for the benefit of all.

It has sometimes been argued that cohesion policy is and should be essentially a tool to redistribute resources from richer to poorer areas. If this route is taken, the next step is to call for measures aimed at compensating very backward areas by providing unconditional support, possibly through automatic devices. This characterization not only looks like a misrepresentation of what cohesion policy today is about, but it actually misses the point of the very meaning of cohesion target in both EU history and its Treaty. Cohesion policy is not about redistribution, is about growth. There are mutual benefits for all member states.

3. Budgetary Importance of EU Transfers for CEECs

The amount of EU level budgetary expenditure on regional policy had ever-increasing weight between the late 1980s and 2000 reaching 0.24% up to 0.4% of GDP (European Commission, 2004). Since that time the ratio has remained at the same level. From the

point of view of the beneficiary countries the maximum level of transfers was fixed at 4% of GDP since 2000, for the period 2007-2013 the capping rate was between 3.2% and 3.8% of GDP for those countries whose per capita GNI was between 75% and 40% of the EU average (Council of the European Union, 2006). For the period 2014-2020, as a general rule, the ceiling is fixed at 2.35 % of GDP (there are only some exceptional cases to increase this ratio by 10 per cent).

These levels reflect relatively low degree of solidarity, although experience has shown that the great proportion of the amounts flows toward the developed regions of the net contributor countries in the form of purchases of finished products, machinery and investment goods. The evidence suggests that, on average, around a quarter of structural expenditure returns to the rest of the Union in form of increased imports. According to model estimations EUR 75 billion benefits are generated for the old EU15 countries as an impact of EUR 140 billion cohesion policy transfers for the Visegrad Countries during the period 2004-2015 (Zawistowski et al., 2011).

Cohesion policy transfers for the first 3 years of membership were laid down in the accession treaties: the 10 new members were entitled for EUR 21.8 billion (EUR 14.256 billion from the Structural Funds and EUR 7.591 billion from the Cohesion Fund) for the period 2004-2006. They were quite modest in size compared to what the less developed old member states received. The official reason was the expected limited absorption capacity in the first years of membership. Structural aid to the new member states amounted to around 0.5% of GDP in 2004, and increased to around 1.3% of GDP by 2006. (The similar figures were between 3.5-4% in Greece or Portugal.) In the period 2007-2013, the 11 CEECs were eligible for EUR 174.72 billion from the Structural and Cohesion Funds. This total transfer amounted to 16.2% of an average annual GDP of the region, which means an annual transfer around 2.3% without national contribution and private co-financing. It means that equal treatment was guaranteed for the new members and the level of funding has become a really important source of modernization. (*Table 1*)

Table 1 EU funds in Central and Eastern European countries (2007-2013)

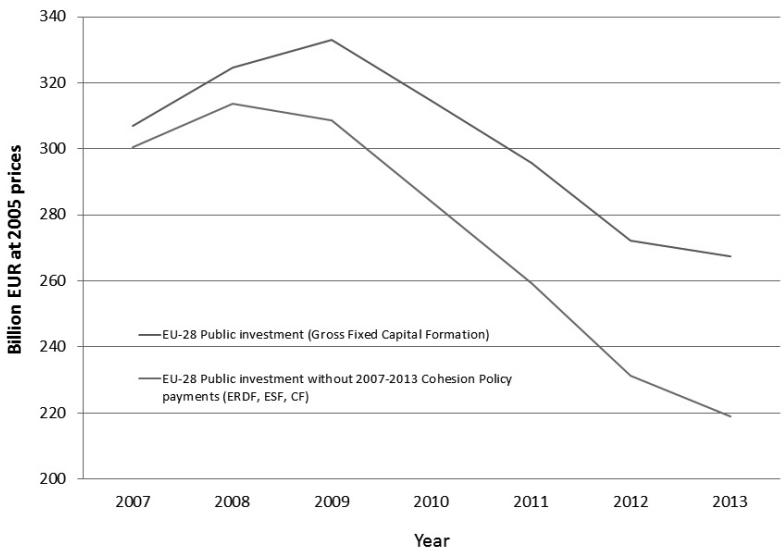
	EU funds 2007-2013	EU funds per capita	Total EU funds for 7 years compared with an average annual GDP
	(EUR billion)	(EUR)	(%)
Bulgaria	6.67	917	16.7
Croatia	1.00	234	2.3
Czech Republic	26.30	2 501	17.6
Estonia	3.40	2 595	18.5
Poland	67.19	1 743	17.2
Latvia	4.54	2 243	19.4

	EU funds 2007-2013	EU funds per capita	Total EU funds for 7 years compared with an average annual GDP
	(EUR billion)	(EUR)	(%)
Hungary	24.92	2 515	25.4
Romania	19.18	956	13.4
Slovakia	11.65	2 154	16.2
Slovenia	4.10	1 993	11.6
CEECs total	175.72	1 830	16.2

Source: KPMG (2014)

In addition, as a result of the crisis, national budgetary expenditures have been seriously restricted. The crisis has had a dramatic impact on national budgets. Public investment measured as gross fixed capital formation in the EU28 declined by 20 per cent in real terms between 2008 and 2013. In Greece, Spain and Ireland, the decline was around 60 per cent. Public investment fell by a third in the CEECs. Without EU cohesion transfers, investments in the EU member states most affected by the crisis would have collapsed by an additional 50 per cent. This could depress growth rates over the medium-term. (*Figure 1*)

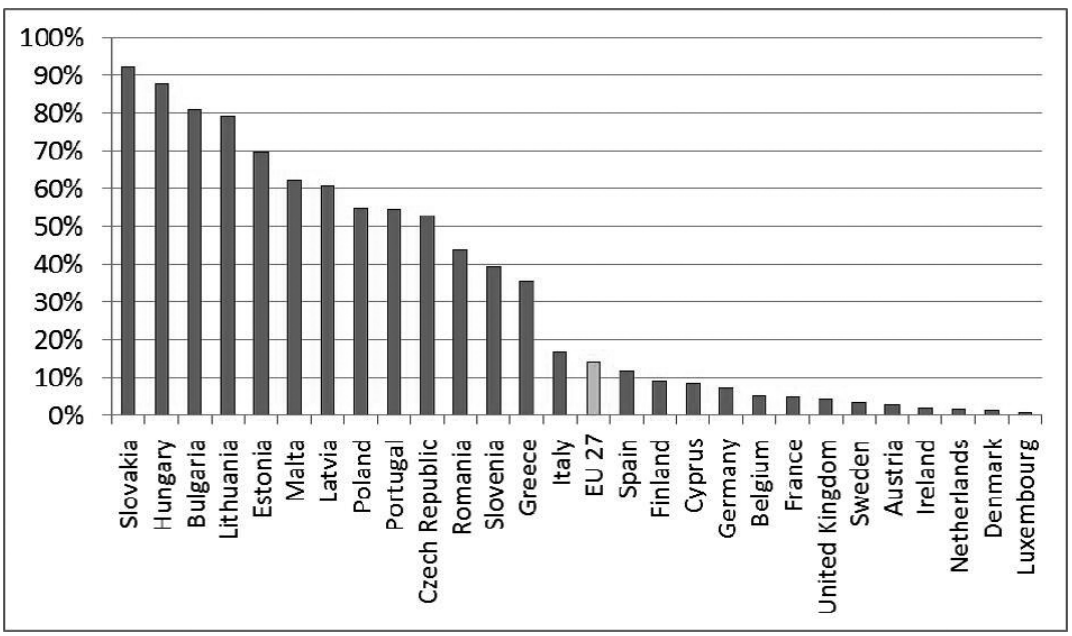
Figure 1 Impact of cohesion policy transfers on public investment trends during the crisis (2007-2013)



Source: European Commission, 2014.

There is increased reliance on cohesion policy transfers to finance growth-enhancing public investment. During the past period cohesion policy transfers accounted for a significant proportion of public investment in the EU member states. In 2010–2012, cohesion policy funding represented more than 60 per cent of the investment budget in CEECs – in countries like Slovakia and Hungary the ratio reached around 90 per cent. (*Figure 2*)

Figure 2 Cohesion policy and national co-financing as % of total public investment (average 2010-2012)



Source: European Commission, 2013.

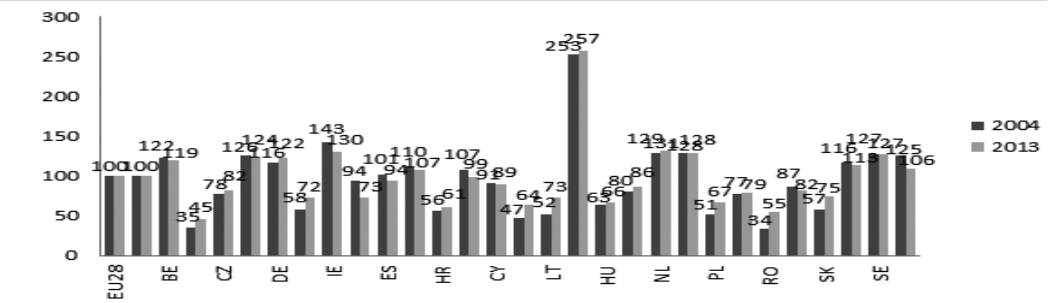
4. The Added Value of EU Level Transfers

The eastern enlargement presented an unprecedented challenge to the competitiveness and internal cohesion of the EU. After May of 2004, the EU's average GDP per head decreased by almost 13 per cent, because the GDP of most of the regions in the new member states were between 30-40% of the former EU15 average. If we calculate with the 12 new countries, including Romania and Bulgaria, the statistical effect was to reduce the EU15 average GDP per head by 18% (European Commission, 2004).

However, contrary to the extremely bad general environment resulted by the international financial and economic crisis, the majority of the new member states

were able to converge toward the EU average: within one decade the relative level of development of the region measured in GDP per capita terms compared to the EU average increased by 15 per cent. It should be stressed that among several advantages of EU membership direct transfers from the EU level budget played a crucial role in improving competitiveness through investments supported by these resources. (*Figure 3*)

Figure 3 Changes in relative positions between 2004 and 2013 (GDP per capita, PPS, EU28=100)



Source: Eurostat (2014), Eurostat (2015)

According to the latest available data published by the statistical office of the European Union the dispersion in GDP per capita across the EU member states remained remarkable, however the new member states' situation improved impressively. Between 2004 and 2013 the relative position of the CEECs compared with the EU28 average increased by 21 per cent in Lithuania and Romania, by 18 per cent in Slovakia, by 17 per cent in Latvia, by 16 per cent in Poland, by 14 per cent in Estonia, by 10 per cent in Bulgaria, by 5 per cent in Croatia, by 4 per cent in the Czech Republic, and by 3 per cent in Hungary. The relative position declined only in the case of Slovenia where the relative position decreased by 5 per cent. The generally favourable performance of the new member states compared with the EU28 average can be partly explained by the implementation of EU funded programmes.

4.1. Contribution to Catching Up

There are several studies about the impacts and results of EU transfers on catching up. Some authors concluded that there is no evidence that the assisted regions display any form of systematic catching up (Boldrin – Canova, 2001). Others concluded that the success is very much dependent on national economic policy incentives which promote structural changes and research and development activities. There is evidence that EU supports are more effective in countries with the right institutions

and indicators of good governance (Cappelen et al. 2003, Ederveen – Groot - Nahuis 2006).

Significant progress has been achieved in terms of qualifying the impact of interventions, especially in large less developed regions, where the overall effects can be measured by using macroeconomic models. The HERMIN model is one of the most well-known econometric model for analysing the impacts of EU level intervention (Bradley–O'Donnell–Sheridan–Whelan, 1995, Bradley, 2006). HERMIN is a macro econometric model that combines both neo-classical and Keynesian elements to analyse in one framework both short-run (demand) and long-run (supply side) effects. The model takes into account that the transfers have the effect of enabling the least wealthy regions to achieve higher levels of investment in human and physical capital than would otherwise be the case, so helping to improve their long-term competitiveness. Some of the gains are due to short-run demand effects, in the form, for example, of a temporary boost to construction. However, around half of the increase in GDP is attributable to supply-side effects, which are important to sustain higher growth rates over long-term. These take the form of increases in physical and human capital and R&D, which serve to push productivity and growth potential. The projected effects of EU transfers differ between countries, partly because of variations in the scale of funding, partly because of differences in the structure of the economy. In general, the countries with large agriculture and basic industry sectors gaining less than those with more services and higher-tech sectors.

Results of the HERMIN model provide quantitative evidence of the positive effects of EU support, in terms, for example, of job saved, created or redistributed. Model estimations for the period 2007-2013 show that cohesion policy has a significantly positive effect, with absolute GDP being some 5-10% higher in most of the new member states than in the absence of intervention. The job content is high, with 2 million net additional jobs predicted by 2015. *(Table 2)* It is important to note that the simulations incorporate only the effects of the EU contribution. The pattern of national spending is assumed to remain unchanged, which seems plausible given that most co-financing will come from money already earmarked for the spending in question.

Table 2 Results of the HERMIN model: Effects of EU transfers for 2007-2013 on national GDP and employment in 2015 (per cent, person)

Country	GDP gain (% above baseline)	Employment gain (% above baseline)	Employment gain (1000s above baseline)
Bulgaria	5.9	3.2	90.4
Czech Republic	9.1	7.1	327.8
Estonia	8.6	5.4	31.0
Ireland	0.6	0.4	8.2
Greece	3.5	2.3	95.0
Spain	1.2	0.8	156.7
Cyprus	1.1	0.9	3.1
Latvia	9.3	6.0	55.4
Lithuania	8.3	4.8	67.7
Hungary	5.4	3.7	147.3
Malta	4.5	4.0	6.9
Poland	5.4	2.8	384.2
Portugal	3.1	2.1	104.8
Romania	7.6	3.2	267.5
Slovakia	6.1	4.0	87.9
Slovenia	2.5	1.7	15.7
Eastern Germany	1.1	0.9	60.0
Italian Mezzogiorno	1.5	0.9	60.1
Total			1969.7

Source: European Commission, 2007.

Another model on the impacts of EU transfers in the period 2007-2013 shows impressive results of EU assistance in the long run (Varga - in't Veld, 2010). This micro-founded dynamic general equilibrium model is a standard DSGE model but with human capital accumulation and endogenous technological change. Cohesion policy interventions were simulated in this model through shocks given to corresponding model variables: 86 interventions were identified which were grouped into 5 main categories (infrastructure, agriculture-industry-services, R&D, human resources, technical assistance). A comparison across countries shows GDP effect proportional to the funds received when the financing of EU contributions is also taken into account.

The model results show that the cumulative net cohesion receipts will reach 17% of the supported countries' GDP and their impact on GDP will reach 14.68% by

2016. For a longer run by 2025, the cumulative GDP effects will approach 45%, which means that the cumulative multiplier will increase from 0.86 in 2016 to 2.63 by 2025. *(Table 3)* The cumulative multiplier was calculated as the cumulative sum of GDP effects divided over the cumulative sum of net cohesion receipts. The multiplier is close to one in the last year of the programming period and increases further in the following years. The multiplier is largest in Spain and Portugal and becomes also large for Slovakia and Poland. Germany and Italy are net contributors and cumulative GDP effects are negative or negligible. It should be emphasized that the multiplier differs according to the different spending categories. The cumulative multiplier for research and development is larger than that for infrastructure. The multiplier of investment in human capital increases sharply in the long run, this type of intervention has long delayed benefits, but the largest long run output effects of all categories.

Table 3 Results of the micro-founded DSGE model: Cumulative GDP effects of cohesion spending in 2007-2013 (in per cent of GDP, in 2016 and 2025)

Country	Cumulative net cohesion receipt	Cumulative GDP effect	Cumulative GDP effect	Cumulative multiplier	Cumulative multiplier
	2016	2016	2025	2016	2025
BG	17.42	13.12	40.30	0.75	2.31
CY	3.05	2.49	6.97	0.82	2.29
CZ	16.84	8.95	32.19	0.53	1.91
EE	22.49	17.23	45.30	0.77	2.01
PL	16.85	17.29	54.10	1.03	3.21
LT	25.08	18.19	55.23	0.73	2.20
LV	24.88	21.33	65.20	0.86	2.62
HU	23.36	19.28	57.14	0.83	2.45
MT	13.35	7.86	20.11	0.59	1.51
RO	13.25	13.00	34.30	0.98	2.59
SK	14.44	15.79	47.61	1.09	3.30
SI	10.10	7.82	21.78	0.77	2.16
GR	5.86	5.49	15.35	0.94	2.62
PT	10.19	11.42	32.19	1.12	3.16
SP	1.29	1.50	4.75	1.16	3.67
DE	-1.24	-0.28	-0.06	-	-

Country	Cumulative net cohesion receipt	Cumulative GDP effect	Cumulative GDP effect	Cumulative multiplier	Cumulative multiplier
	2016	2016	2025	2016	2025
NMS	17.06	14.68	44.90	0.86	2.63
EU15	-0.95	-0.62	-0.78	-	-

Source: Varga - in't Veld, 2010.

According to the latest cohesion report prepared by the European Commission "Cohesion Policy in the 2007–2013 period made a substantial contribution to growth and jobs. It is estimated to have increased GDP by 2.1% a year on average in Latvia, 1.8% a year in Lithuania and 1.7% a year in Poland in relation to what it would have been without the investment it has funded. It is also estimated to have increased the level of employment, by 1% a year in Poland, 0.6% in Hungary, and 0.4% in Slovakia and Lithuania. The estimates of the longer-term effects are larger because of the impact on the development potential of economies. In both Lithuania and Poland, GDP in 2020 is estimated to be over 4% above what it would be without the investment concerned and in Latvia, 5% higher. Over the same period, Cohesion Policy has been important in sustaining public expenditure in vital areas, such as R&D, support for SMEs, sustainable energy, human resource development and social inclusion." (European Commission, 2014. p. 9)

4.2. Qualitative Changes in National Development Policies

Most of the effects of cohesion policy cannot readily be expressed just in quantitative terms (Bachtler – Taylor, 2003; Kengyel, 2008). Beyond the net impact of EU transfers on GDP or employment, its added value arises from other aspects, like the contribution made to regional development policies by factors such as:

- multi-annual programming (strategic planning, integrated development policies);
- partnership;
- evaluation;
- co-operation between regions (exchange of experience and good practice);
- political added value.

Multi-annual programming has been one of the main successes of the Structural Funds method and the benefits of this approach have become clearer over time as member states capacity to plan programmes over a number of years has

developed. This approach has facilitated longer term and more strategic planning in CEECs. The EU programming approach has promoted strategic dimension in regional development policy making. From a financial perspective, multi-annual programming gives rise to a greater degree of certainty and stability as regards the availability of funding than annual budgeting. This is particularly relevant in the context of major infrastructure investment which takes years to complete.

Partnership has widened and deepened and has extended in some cases beyond the Structural Funds into other areas of national and regional administration. Originally, partnership was conceived primarily as vertical relationship between the Commission and national, regional or local authorities, the horizontal dimension of partnership, including a wider range of stakeholders at local, regional and national level, has grown stronger over time. When it works effectively, partnership adds value in many ways. It stimulates ideas for projects, through partners communicating opportunities in relation to Structural Funds requirements. In programme design, it helps to focus interventions on the needs of the region or particular target group. Partnership has brought enhanced transparency, co-operation and co-ordination to the design and delivery of regional development policy.

Evaluation of cohesion policy programmes developed and improved during the past programming periods, leading to greater transparency and accountability in the management of the funds. The strong emphasis placed on monitoring and evaluation has been one of the most important effects in the field of public expenditures. As a direct result of the EU level rules, considerable progress has been made in terms of integrating monitoring and evaluation into regional development programming across the member states. In Central and Eastern European countries, there was little or no culture of evaluation in economic development prior to the Structural Funds being introduced. Evaluations are now required to be undertaken at an ex ante stage by member states, at mid-term by member states in co-operation with the Commission and ex post by the Commission.

The EU level regional development policy rules provide a common international policy framework and timetable for regional development programming. As a result, a class of experts has progressively developed across Europe with a common background, culture and competences, delivering programmes which, while they vary significantly, have a core of common features. This provides scope for cross-national networking, which broadens horizons and facilitates the dissemination of the best practice.

There is also a clear "political added value" of the cohesion policy. An important intangible effect is to make the EU more visible to citizens, enterprises, communities and public authorities. Among the perceived benefits is stronger support for European integration. "The cohesion policy makes the EU visible for citizens. Projects supported by the Structural Funds show in regions and cities of all

member states that Europe cares and matters. Structural Funds are the vivid proof of the EU's solidarity with poor and those in difficulties." (Hübner, 2005. p. 1.) There are tangible outcomes in terms of the encouragement given to regional and local organisations to become involved in European political and policy debates and to internationalise their operations.

Concluding Remarks

According to the long-term experiences and the latest available data published by the Eurostat, it can be seen that there has been considerable approximation between the performance of less developed Central and Eastern European member states and the EU average level of development. EU regional policy support is, of course, only part of the explanation for this process, and several other factors have also contributed to the catching up processes. The most important factors that support cohesion are the improvement of the conditions of employment and the strengthening of the economic potential of the more backward regions. The crucial element in accelerating the process of catching up in these regions is to improve the conditions of economic development, since these regions are in a disadvantageous position in every respect. It should be noted that the measures promoting cohesion are not meant to replace the EU policies driven by free market principles, but are applied parallel with and in harmony with them: the cohesion measures are a concession to interventionism, but within the general framework of the market.

The priorities and actions defined by the member states should strengthen the regions' capacity by supporting R&D and knowledge-intensive investment. The key challenge of the EU and member states is to improve the innovation capacity and R&D in the regions and encourage environment of strong regional networks between the industry, universities and research institution. Innovation and processes of learning, as well as institutions have a key role in fostering development of the regions, ensuring the root for sustainable growth.

However, it is a complex and permanent process that requires finances. Despite significant increase in the levels of funding, the steps being taken by the EU to support economic and social cohesion are still relatively modest. Overall levels of funding for regional development have remained low in comparison with the GNI of the EU. On the other hand, these transfers could play an important role in the catching up processes of the beneficiary countries. Because of enlargement and increased disparities among member states, there is no reason why cuts the budget of the cohesion instruments could be justified. The costs of non-cohesion would easily outweigh any budgetary savings in the long term. Cohesion policy should play a crucial role in boosting Europe's economic competitiveness, fostering social cohesion, and creating more jobs.

According to several model estimations, the macroeconomic effects of the subsidies have proved to be far-reaching. There is evidence of significant growth in GDP and a considerable reduction in unemployment compared with the case without subsidies. EU regional policy transfers have the effect of enabling the least wealthy regions to achieve higher levels of investment in human and physical capital than would otherwise be the case, so helping to improve their long-term competitiveness. The main priority of the EU regional policy is to create conditions which allow self-sustaining development of the regions. Consequently, mobilisation of the human capital is taken as main driver engine in achieving this with the increasing rate of innovation.

Beyond its quantitative effects, the added value of the policy arises from other aspects, like the contribution made to national regional development policies by factors such as multi-annual programming frameworks, partnership, evaluation, co-operation between regions, and its political added value. These impacts have clearly contributed to the "Europeanization" of objectives, contents and operation of national development policies. The structure of EU cohesion policy – based on co-financing by the member states, partnership among all interested actors, and multi-annual programming – describes a policy set which is unique, when the whole spectrum of EU policies is taken into account. Indeed, it provides a framework to finance investments for sustaining development of regions based on coherent long-term programmes, conditional on a set of enforceable rules. It has become clear, that cohesion can be better achieved if it is implemented within a multi-level governance system. Several economic reasons back this statement. Firstly, the EU policy provides the incentive for institution building and empowerment of public administrations. The achievement of some common institutional features can allow a degree of communication and co-operation among development administrations of EU member states. Secondly, the EU cohesion policy provides the adequate framework for the implementation of major EU network projects in the areas of material and immaterial infrastructure, namely transport and research, which are essential to increase EU competitiveness.

In the future, greater care must be put into creating adequate framework for national and regional authorities to design the appropriate governance of the policy, to strongly invest in institution and capacity building, to improve evaluation systems, to create true partnership with social and economic actors. Subsidiarity must be more effectively implemented, through a more clear-cut separation of responsibilities with central and regional governments playing a focal role in establishing implementation rules, allocating resources among targets, areas and projects, running monitoring and control. In this reformed scheme, the Commission could play a higher strategic role in guaranteeing for the governance system, in supervising national rules and monitoring and control systems, and in co-ordinating

the horizontal co-operation among regions and member states.

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