

ICPS newsletter[®]

Regional policies are not reducing gaps in regional development

In the years since Ukraine became independent, the gap in socio-economic development among its regions has grown, clear evidence that the country's approach to regional development is ineffective. The regulatory instruments being applied contain flaws that have resulted in their having no impact. A strategy for better regional policy must be based on the concept of equal development in all regions and be oriented on strengthening the influence of local governments on economic development

Equality or efficiency?

Each country determines its policy towards regional inequalities based on the combination of a number of factors:

- economic reasons, such as the most efficient application of production capacities;
- social reasons, such as promises made by politicians to provide full employment and increased well-being;
- environmental reasons, such as the impact of air pollution in highly populated or over-populated industrial areas;
- political reasons, such as the impact of interregional inequalities on election results.

The aims of regional policy can typically be defined as a choice between:

- gross national efficiency, which aims to maximize net national wealth through a more efficient redistribution of regional resources,

and

- interregional equality, which includes a more equitable distribution of revenues, employment or infrastructure.

Depending on the chosen balance between equality and efficiency, a country's regional policy can stimulate greater private investment, lower labor costs and capital outlay, increased labor supplies, improved attractiveness as a place to live, and other factors in the socio-economic development of a region.

A growing development gap

Ukraine chose a gradual reduction of the differences in economic development among regions and the social security of its

citizens as among the top aims of its regional policy. Still, in the years since the country became independent, the gap in socio-economic development among its regions has deepened, confirming the ineffectiveness of Ukraine's regional policies. Thus, by 2001, the difference in the size of per capita GDP between the national average and the average in specific oblasts ranged between -51% and +203%; in 1996, the range was -47% to +42%.

Among key problems are:

- unclear goals and priorities in policies intended to overcome interregional development differences;
- lack of criteria for providing centralized assistance to underdeveloped regions;
- scattered and untargeted assistance;
- underdeveloped assistance mechanisms.

The basic document that delineates Ukraine's regional policies is the "National Regional Policy Concept of Ukraine", approved in 2001. Yet, the first positive steps in terms of formulating a legislative base that would allow the successful implementation of a policy of regional equalization were taken only recently. The Government drafted a number of bills directed at dealing with economically depressed areas and stimulating their growth—in particular, a draft law "On stimulating regional development".

What's wrong with the current approach?

Among the key measures in Ukraine's current regional policy are:

- implementing special investment regimes called "free economic zones" (FEZ);
- a system of budget transfers;

- sector-oriented programs providing financial resources to support depressed regions;
- centralized investment in the socio-economic development of the regions;
- support of socio-economic development in the mountain regions.

Free/special economic zones. As of 15 September 2003, 11 FEZs have been established in Crimea and 8 oblasts. In addition, one oblast, 39 counties and 49 towns have been recognized as "priority development areas" (PDA). Yet the share of overall foreign direct investment in Ukraine that goes to FEZs and PDAs is miniscule. Since there is little difference between their sectoral investment profile and that of the countries investing in Ukraine, this could mean that current conditions are not especially attractive to investors. Moreover, budget outlays and the cost of jobs gained or retained have been too great and do not pass the litmus test of economic efficiency.

Budget transfers. Budget transfers from the center to local governments are intended to provide all citizens with an equal level of public services, regardless of their place of residence. This goal is usually achieved by redistributing public resources between budgets of different levels, based on the principle of assessing the difference between potential revenues and essential expenditures. In Ukraine, the transfer mechanism works inefficiently for several reasons:

- An unclear division of functions among different levels of government leads to confusion over who provides what public services.
- The system for calculating the needs of a particular region for specific public services is underdeveloped.
- Insufficiently transparent methods that use budget transfer formulas to determine adjustments offer opportunities for "spinning" data.
- Their weak revenue bases offer local administrations little incentive to actively stimulate local economic development.

Sector-based programs. Quite often, assistance is provided to a particular area or group of areas within the context of sector-specific programs. The effectiveness of such programs is quite low, however, partly because they are:

- frequently not coordinated, whether among themselves, or in terms of national policy priorities;
- developed apart from budget planning, which leads to the adoption of obviously unfeasible measures. As a result, most already-approved state programs are not being carried out for the simple reason that no money was allocated for them by either the Government or the local administration.

Centralized financing of regional socio-economic development. In recent years, the level of government spending has not had a significant impact on the investment attractiveness of the regions, because capital investments based on Budget funding are worth less than 1% of GDP today. Among the weaknesses of such an approach are three key drawbacks:

- Typically, the main entities controlling the purse strings in such programs are ministries and other central bodies, and local administrations have no impact on how the money is spent.
- The main portion of these costs is intended for handling exceptional or emergency situations, not on strategic development in the regions.
- The allocated costs are far below the real investment needs of the regions.

Support for the socio-economic development of the mountain regions.

One specific policy direction aimed at areas with unique problems is assistance provided to residents of mountain regions. The Law "On the status of mountain settlements in Ukraine" decrees that residents of these areas should receive a 20% bonus on their pensions, stipends and government salaries. The Law is being supplemented by a Program for the Development of the Carpathians. The main flaw with this form of assistance, as with many other state programs, is the insufficient funding allocated for the purpose.

Finding the right balance

The further development of Ukraine's regional policy needs to be grounded in an appropriate balance between equality and efficiency, taking into consideration two critical factors:

- The low mobility of the workforce makes it impossible to depend entirely on market mechanisms for regional development and forces the state to resort to the redistribution of resources in support of depressed areas.
- Limited resources mean that efforts need to be concentrated in those specific regions that need the most centralized intervention.

At its current stage of development, Ukraine must pay a good deal of attention to the concept of equality, after determining the standard of living that can be guaranteed for every citizen, regardless of their place of residence. At the same time, regional policies should be aimed at empowering local administrations to have real influence on local development.

To reach this goal, the way regional policy works needs to be reformed along certain lines:

- Precise criteria need to be developed to define problem regions, in order to ensure the transparency of decisions to provide state support.
- Centralized assistance needs to have a well-grounded timeframe.
- Local governments should be actively involved in the development and implementation of specific measures aimed at reducing inequalities among regions.

Among the nationwide policy measures that can be taken to spur regional development, a few are indispensable:

- increasing worker productivity and encouraging the inflow of investment by:
 1. reforming higher education and organizing training and professional development courses;
 2. investing in transport and telecommunications infrastructure;
- improving the supply of labor by reforming immigration policies and encouraging greater mobility in the workforce;
- reforming the budget transfer system by:
 1. ensuring that local governments can make use of real fiscal levers such as changing local taxes, fees and development budgets, to stimulate economic development;
 2. increasing the attractiveness of depressed areas as places to live in

by gradually raising the quality of public services.

An EU model for regional policy

Among EU countries, the experience of organizations involved in regional policy has proved the importance of certain basic principles:

- **A solid legal foundation.** The distribution of centralized resources to assist particular regions must be based on precise and transparent criteria. Although decisions to provide subsidies that are underwritten by EU structural funds are not always free of political pressure, the basic rules and regulations leave limited room for maneuvering and make it possible to expect objectivity in decisions affecting distribution of resources.
- **A coordinated approach among all stakeholders.** Typically, regional problems encompass a variety of social and economic spheres, which means their resolution is in the hands of different levels of government. The experience of EU regional policy-makers has shown that the financial contribution of key stakeholders to regional development programs can become the formal confirmation of their commitment and thus encourage more effective planning and implementation of regional policy.
- **The principle of empowerment.** The EU intervenes only when a member country cannot successfully carry out the project on its own.
- **Appropriate information systems.** Two kinds of information are usually needed:
 1. a database that describes the social and economic development of the regions; and
 2. data that allows for real-time tracking of the results and effectiveness of implemented measures.
- **Flexible programs.** Considerable variations among regional problems within Europe and EU experience in resolving these have confirmed the importance of providing regions with a choice among different approaches to regional policy. ■

*For more about regional policy and trends in regional development, read the Center's **regional trends**. For additional information, contact Oksana Remiga at oremiga@icps.kiev.ua or call +380-44-236-4477.*

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