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CURRENT SITUATION AND FUTURE PERSPECTIVES OF REGIONAL POLICY IN CROATIA

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ABSTRACT

Regional policies in European Union member countries have undergone significant changes in recent two decades. New policy approach is particularly focused on issues such as regional competitiveness, role of regional and local actors in managing development, multi-annual programming and policy evaluation. Latest policy trends have not yet been recognized by Croatian policy-makers. Croatian regional policy is still based on old-fashioned instruments such as tax relief's and intergovernmental transfers, while a meaningful approach to supporting regional growth and competitiveness is lacking. Accession process could become a catalyst for setting up new and modern regional policy, but on the other hand it could result with having two parallel systems of supporting regional development based on entirely different principles. On the basis of the identified trends in European regional policies and the analysis of current regional development and regional policy context, the paper provides recommendations for improvement of the current policy approach.

1. INTRODUCTION

The regional dimension of development processes has received substantial attention of policy-makers in the last few decades. Regions and cities have been recognized as key drivers of national growth and competitiveness, which deserve to be carefully addressed by national policy-makers. Traditional regional policy, viewed from a sector perspective, and focused exclusively on the reduction of regional disparities, has undergone major changes in many European countries, as well at the European Union level, which have reflected these new understandings. Role of regional and local actors in managing regional development policy is now much more appreciated and emphasized. The East European transition countries have in general paid little attention to the regional issues in the beginning of the 1990s, due to preoccupation with macro-economic framework and ensuring stability. This has changed after reaching stability, under the influence of accession process and preparations for participation in Cohesion policy and following sharp increase in regional disparities in most countries which called for policy response. Today, regional policy frameworks are in place in all new

member states, even in ones like Slovenia which are facing very small regional disparities. The rising interest for regional policy and regional development calls for examination of its current standing in Croatia as well as future perspectives in light of accession process. The position of regional policy in Croatia is evaluated from two perspectives. The first one can be labelled as a classical one, as it is based on the presumption of existence of significant regional disparities as an important factor for designation and management of regional policy. Our level of expectations regarding the degree of development of regional policy and its relevance in comparison with other public policies will thus be in correlation with identified regional disparities. If more significant regional disparities exist, it would be reasonable to assume that a stronger regional policy should take place. The second perspective can be labelled as a modern one, as it reflects the latest developments in national regional policies and Cohesion policy and compares them with current practice in Croatia. Since the process of developing a modern and coherent regional development policy in Croatia is still underway and going parallel with the accession process, the issue of adjusting to Cohesion policy requirements is also examined. The experience of new member countries shows that, in most cases, the accession process has played a major role in setting up a modern and coherent national framework in the field of regional policy and Structural Funds management. Will the same scenario happen in Croatia? Is the accession process a catalyst for setting up new, modern, approach to the promotion of regional development? It is clear that Croatia will have to adjust to requirements related to effective management of Structural Funds, most notably in case of setting up necessary institutional and programming framework and ensuring adequate institutional capacity. Still, it remains to see how much will existing instruments of regional policy be adjusted and made complementary to Structural Funds operations as well as how much will Structural Funds be exploited for achieving national regional policy objectives.

2. OVERVIEW OF KEY REGIONAL POLICY DEVELOPMENTS IN EU MEMBER STATES

Over the last two decades and more, national regional policies in European countries have experienced considerable changes. Over the last two decades and more, national regional policies in European countries have experienced considerable changes. Contemporary regional policy is much more about inducing indigenous economic development than supporting the transfer of external investments to disadvantaged areas. The new regional policy has replaced the previous focus on the equity issue with objectives covering both equity and efficiency. There has been growing emphasis on the role of regional competitiveness in contributing to national growth and development. Policy instruments have expanded with those covering all regions rather than just those disadvantaged. In Finland, the traditional focus on rural areas and on the prevention of out-migration has been reduced; the key policy objective is now to maintain population/development in the main urban centres in each region – a focus on regional growth poles (Yulli, Wislade, 2001). The overall policy approach has become much more strategic. While traditional regional policy was quite selective, characterised mainly by the individual project approach, the new regional policy is based on multi-annual programming, multi-sector operations and strict evaluation in different programming phases. Policy actions have become broader and more complex

than before, covering various sectors and including numerous actors at different levels. The regional level is now receiving much more attention in policy design and implementation. Policies are being tailored to specific needs of individual regions, more weight is being put on policy coordination at regional level and more recognition is given to the role of regional urban centres in economic development (Bachtler et al, 2003). These processes take place in line with processes such as decentralisation and regionalisation. This is especially obvious in some countries like Italy and United Kingdom, where broader constitutional reforms have been undertaken in order to strengthen the position of the regions. In France, the point has been made that regional policy should not be imposed by central government; instead, it should emerge from a “bottom-up” process involving local actors, coupled with a “top-down” approach that integrates, provides balance and ensures equity. (Yulli, Wishlade, 2001). EU Cohesion Policy has had especially strong impact on national regional policies. Leonardi (2006) states that one of the most important contributions of the Cohesion policy has been the rediscovery of the territorial dimension in regional policy instead of the previous sectoral approach:

“The formulation and implementation of Cohesion policy has forced policy-makers at European and national levels to re-emphasize the meaning and implication of geographic space, i.e. the conceptualization of regional policy as a territorial policy rather than a sectoral one.”

Promotion of multi-annual programming and renewed emphasis on the importance of institution-building and administrative capacity are some of the important contributions of Cohesion policy to the evolution of regional and national development policies in member countries and elsewhere. Multi-annual programming has facilitated greater strategic planning, especially at the regional level, which in many countries was a neglected aspect of regional development. From a financial perspective, multi-annual programming gives rise to a greater stability in the availability of funds for economic development than does annual budgeting (Mairate, 2006). Furthermore, promotion of the partnership principle has allowed the entry into policy process of a number of actors that before had often been systematically excluded from participation in the national regional policy. Another important aspect of EU impact on national regional policies is reflected through Regional Aid Guidelines aimed to regulate state aid for regions lagging behind.¹ The Guidelines set “quotas” for the designation of assisted areas at European and national level and restricted intensity of aid to the companies. This has resulted in significant cutbacks in assisted areas coverage for most of the countries and decreased flexibility of national regional policies. Yulli and Fishlade (2001) analyze also changes in policy instruments and highlight the following long-term trends:

- shift from fiscal aid and towards financial incentives (grants in particular)
- withdrawal of social security concessions in response to competition policy pressures

¹ National regional aid consists of aid for investment granted to large companies, or in certain limited circumstances, operating aid, which in both cases are targeted on specific regions in order to redress regional disparities. Increased levels of investment aid granted to small and medium-sized enterprises located within the disadvantaged regions over and above what is allowed in other areas are also considered as regional aid. (Guidelines on national regional aid, Official Journal of the European Union, C 54/13, 2006)

- a reduced stress on investment-related support and an increasing emphasis on “softer” measures to improve the business environment (including programme-based support)
- an increasing tendency for support to be offered on a competitive basis up to a specified budget

These changes do not imply that old instruments such as investments into physical infrastructure have been abandoned. They still play an important role, particularly in countries with accentuated regional disparities, but they have been complemented with many other policy instruments of different scope and nature. In the case of new member states, Bachtler et al (2003) note that EU regional policy has tended to dominate regional policy debates, activities and resources. In the beginning of 1990 countries have been focused on macroeconomic reforms, while regional policy draws attention only recently with the advancement of the accession process and due to increased regional disparities. Regional policies, in some form, now exist in each new member state; relevant institutions are being created at national and regional levels and a range of policy instruments are in place.

3. REGIONAL DEVELOPMENT IN CROATIA – IS THERE A CASE FOR REGIONAL POLICY?

Croatia’s regional development is marked by pronounced regional disparities for a long period of time. Before 1990 and the beginning of the transition period, disadvantaged areas mainly included those close to the border with Bosnia and Hercegovina, ranging from the hinterland of Dalmatia, central mountainous parts of the country such as Lika and Gorski kotar up to the Banovina and Kordun.² Also, parts of the northern and eastern Croatia (Slavonia) have been identified as disadvantaged areas and included in special government schemes created to enhance economic and social conditions in these areas. Some areas such as Lika, the hinterland of Dalmatia, but also the majority of the islands have for a long time suffered from unfavourable geographic conditions, reflected primarily in bad transport communications with major urban areas. Geographic isolation coupled with other unfavourable economic and social factors has resulted with intense and long term migration which has severely deteriorated the human resource base and seriously endangered their long-term development perspectives.³ Inherited regional disparities before 1990 have been further increased by the consequences of military aggression on Croatia. Namely, most of the already numbered lagging areas have suffered high direct and indirect war damages during the 1991-1995 period. The result was a significant loss of population due to outmigration and loss of lives, devastated transport and communal infrastructure, destroyed production capacities, etc. Although the majority of direct war damages have been repaired in the meantime, indirect effects such as absence of major foreign direct investments into production facilities are still obvious, particularly in the areas outside of the capital city which attracted by far the most of the foreign investments.

² These are today areas covered by Split-Dalmatia, Šibenik-Knin, Zadar, Lika-Senj, Primorje-Gorski kotar, Karlovac and Sisak-Moslavina county.

³ This is evident even in case of islands where economic conditions have been considerably improved due to recovery in tourism sector in last decade, but the problems of low density and ageing population still remain.

Furthermore, transition difficulties, including falling apart of eastern European and the former Soviet Union market as well as failures made during privatisation process, had further negative repercussions on regional development. This is particularly the case with counties heavily dependent on socialist industrial giants, such as Sisak-Moslavina, Šibenik-Knin, Brod-Posavina County and others, which are now faced with high unemployment as the restructuring of local industrial base has not been over yet.⁴

Changes in regional and local administrative system are also one of the aspects of post-1990 political changes with considerable impact on regional development. Croatia is today consisted of 550 local units and 21 county units, while in 1990 there have been 110 local units and 10, the so called, associations of local units. Various analysis have already indicated that rapid increase in number of local units has resulted with existence of too many local units with limited financial and organisational resources which are insufficient to effectively manage local unit's functions (Ott, Bajo, 2001; Hrvatski pravni centar, 2001). Introduction of regional administrative units (counties) in 1992 has been a positive step in promotion of more decentralized approach to management of country's development. Still, restricted financial and administrative powers of the counties along with other factors such as lack of organisational capabilities, lack of inter-county cooperation and small size of some counties have diminished so far potential role of regional structures as drivers of regional development.

Process of accession of Croatia to the European Union also bears important effects for regional development. It is reasonable to assume that different regions will adjust differently to new circumstances. Empirical studies based on cases of new member states show that processes of transition and enlargement have been associated with increasing regional disparities. Bradley, Petrakos and Traistaru (2005) point that "...spatial adjustments have been favouring metropolitan and western regions along the border with EU." Empirical studies on Hungary show that FDI and domestic capital prefer metropolitan and western regions, turning an already unbalanced pre-1989 situation of the regions into a serious core-periphery and east-west disparity (Nemes-Nagy 2000, Lorentzen 1999). Similar trends have been detected in Poland (Gorzalek, 2000) and other Central and Eastern European countries (Petrakos, Psycharis, Kallioras, 2005). Significant and increasing east-west division is already the case in Croatia, as the analysis of disparities in next subchapter shows, meaning that potentially stronger inflow of FDI due to accession could further exacerbate regional disparities.

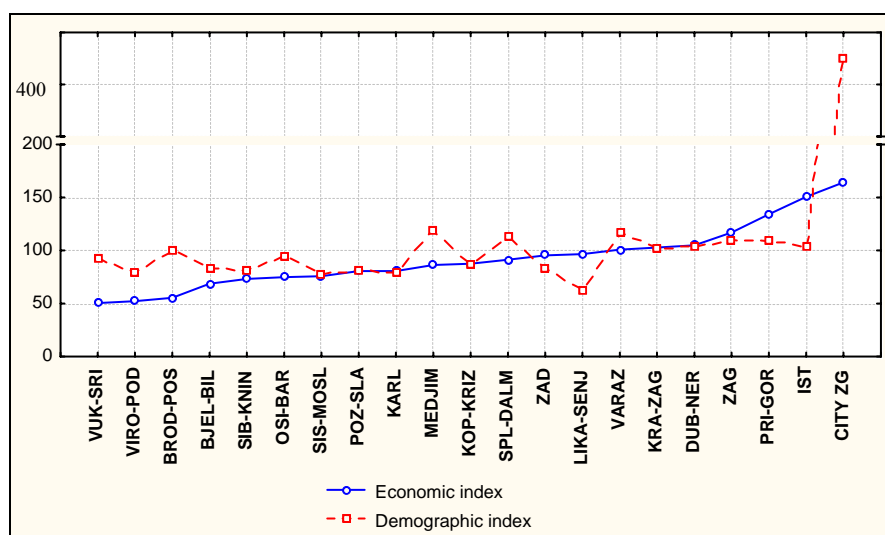
3.1 Regional disparities in Croatia

Before moving to the next section, a short empirical review of regional disparities in Croatia is presented in order to get more precise picture about the extent and dynamics of regional disparities, as well as the location of lagging areas. The review starts by using two composite indicators previously developed in a study for the Ministry of Sea, Transport, Tourism and Development with the purpose of categorisation of local and county units according to their development level (for more information see Puljiz et al,

⁴ County unit is equivalent to NUTS III level units.

2006)⁵. Figure 1 shows rankings of the counties according to applied economic and demographic indexes.

Figure 1 Counties according to economic index (2004) and demographic index (2001), Croatia=100



Source: Author's calculation on the basis of data from Croatian Bureau of Statistics (CBS), Unemployment Service and Ministry of Finance

Note: Economic index is calculated on the basis of values for year 2004, while demographic index is based on 2001 values.

Values of the economic index range from 50,4 in case of Vukovar-Srijem County up to 164,2 for City of Zagreb which makes more than three time the difference in the value of the index. The City of Zagreb is followed by two counties in the western part of the country bordering EU, Istria and Primorje-Gorski kotar County. On the other side, two most disadvantaged counties include Virovitica-Podravina and Brod-Posavina County, both situated in the eastern part of the country. Values of the demographic index range from 62,5 for Lika-Senj County up to 425,9 in case of city of Zagreb.⁶ If we exclude the City of Zagreb and look at the value of the next county with highest value, i.e., the Međimurje County, with an index of 119,2 , and compare it with Lika-Senj County - than the differences are less pronounced than the ones according to economic index. It

⁵ As part of the National Strategy for Regional Development authors have developed a model for assessment and categorisation of territorial units according to development level. Development is measured by economic and demographic index. Economic index is calculated as weighted average of three indicators: personal incomes per capita, unemployment rate and local and county budget revenues. Demographic index is calculated as weighted average of census population change, rate of educational and population density. For more information about the calculation of indexes see «New approach in development level assessment and categorisation of territorial units», IMO, 2006.

⁶ It should be taken into account that City of Zagreb represents a typical urban agglomeration and therefore it's economic and, especially, demographic characteristics are difficult to be directly compared with the ones of other counties which represent a combination of rural and urban areas.

is interesting to note that distribution of the counties according to applied indexes varies considerably.⁷ The most extreme example is the Lika-Senj County with good economic results and quite low demographic index. Such results indicate the complexity of development features that exist already at the very low geographic level such as county level.⁸ Puljiz and Maleković (2007) analyse dynamics of personal income and unemployment inequalities in Croatia in the period 2000-2005, applying various inequality measures. Table 3 summarizes the key results. The most pronounced inequality has been recorded in terms of the unemployment rate, both at the beginning and at the end of the period. According to all applied indicators an increase in regional inequality has occurred. The highest increase occurred in terms of unemployment rate, and a least one according to incomes per capita.

Table 1 Dynamics of regional inequalities on county level

	Income pc 2000	Income pc 2005	Gross wage pc 2000	Gross wage pc 2005	Unemployment rate 2000	Unemployment rate 2005
Max/Min	2,0	2,2	2,5	2,7	2,7	4,2
Weighted coefficient of variation	0,23	0,25	0,28	0,31	0,31	0,36
Gini coefficient	0,124	0,140	0,150	0,170	0,175	0,205
Theil index	0,057	0,058	0,077	0,083	0,085	0,107

Source: Puljiz, Maleković (2007)

Note: Income per capita includes data on wages and pensions. Gross wage is equal to wage before taxation.

Puljiz and Maleković (2007) also provide comparison of regional inequalities in Croatia with other EU member states. According to GDP per capita, Croatia is middle-ranked among the EU-27 countries, but according to the unemployment rate, Croatia belongs to group of countries with highest regional inequality. Obviously, the unemployment rate currently presents the most important issue of regional disparities. The applied inequality measures have once again confirmed the existence of considerable regional disparities. Data also revealed that an increase of disparities has occurred in period 2000-2005. Areas lagging behind are mostly concentrated in the eastern part of the country and along the border with Bosnia and Herzegovina, while the most advanced areas include City of Zagreb, Istria and Primorje-Gorski-Kotar County. With respect to the relation between disparities and regional policy, it can be concluded that the size of the disparities and their negative dynamics in this case provide enough grounds *per se* to promote a strong regional approach to the country's development which would take more into account existing regional differences.

⁷ Coefficient of correlation of the two indexes is 0,43.

⁸ Average number of the population at the county level is around 211 thousands, while average size of the county is around 2.700 sq. km.

4. CURRENT APPROACH TO REGIONAL DEVELOPMENT

Although it could be expected that the existence of significant regional disparities would lead to the implementation of a strong regional approach in national development policy, this has not been the case in Croatia. Regional policy is still undergoing a process of setting up the first, necessary preconditions such as the legal and institutional framework. Simultaneously, sectoral policies are, in most of cases, missing a regional dimension clearly indicating. Reasons for slow development of regional policy are multi-fold, but some of them could be identified as the most relevant ones. First, just like in the case of other transition countries, the beginning of the 1990s was the period of preoccupation with macroeconomic framework. Problems with high inflation in the former state have continued in independent Croatia until the implementation of the Stabilisation programme in 1993. In such conditions, economic policy has completely focused on maintaining stability at the macro level, without taking into account development particularities, problems and potentials of different regions and urban centres. Also, previous negative experience with regional policy in former state was probably one of the reasons why state officials as well as part of the expert community had no understanding for such a policy.⁹ An additional aggravating factor was the presence of strong centralisation during 1990s, which has been justified by the war. In such circumstances, the political will to implement public policies with strong regional dimension was absent.¹⁰

A first change in the governments' attitude came in second half of nineties. However, the change was not driven by the recognized necessity for introduction of modern regional policy, but primarily by the negative consequences of homeland war during 1991-1995 period. The Law on Areas of Special State Concern, adopted in 1996, represented the first law particularly dealing with particular state support for one part of the national territory. The Law has introduced various types of incentives for war-torn areas (former occupied areas). Focus has been primarily on reconstruction of infrastructure and housing stock and in that respect significant results have been achieved. However, the support for recovery of the destroyed economy has not been that successful and diminished good results in reconstruction of housing and physical infrastructure. Concentration of support on war-torn areas has resulted with neglect of other areas. This has been partially corrected with the adoption of the Islands Act in 1999, Act on Hilly and Mountainous Areas (HMA) in 2002 and as well with the extension of the Areas of Special State Concern (ASSC), also in 2002, which have significantly extended the territorial coverage of regional policy.¹¹ Finally, in 2002 special Law on Reconstruction of City of Vukovar has been passed.¹² All laws have

⁹ In former Yugoslavia, regional policy was conducted in centralized manner, relying mainly on grants for investments into industrial capacities in lagging regions. Some of the investments turned out to become major state failures marking whole policy as a fiasco.

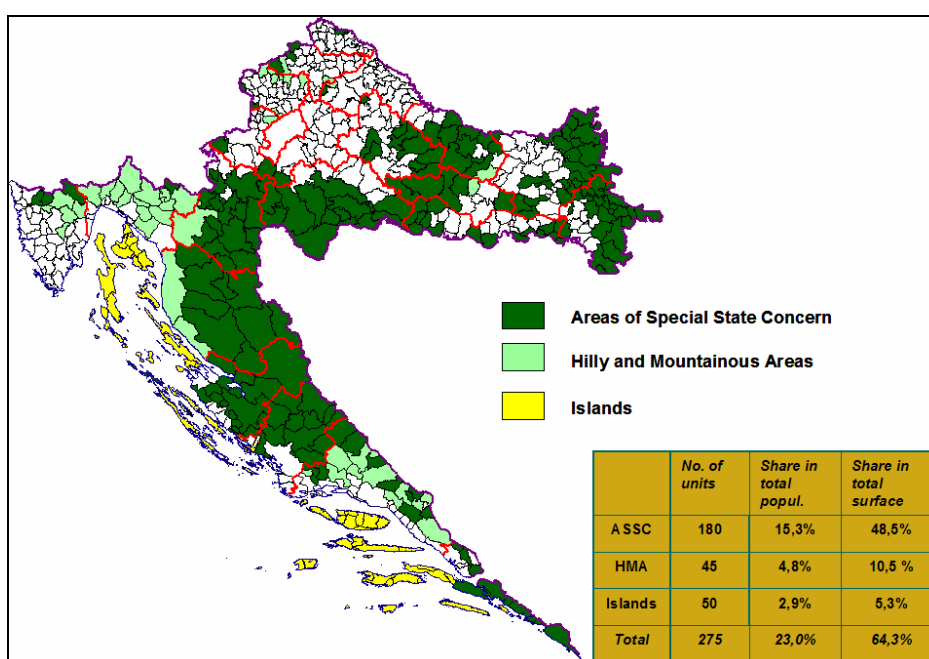
¹⁰ How much has regional policy been disregarded during 1990-ih witnesses the fact that until signing the Stabilisation and Association Agreement with European Union, term regional policy could not be found among the official strategic, operational or legal documents and regulations.

¹¹ Hilly and Mountainous Areas have been created with a purpose of mitigating the problems which arouse from geographical characteristics (height, slope, climate, etc.) and in order to create preconditions for raising the standard of living.

¹² City of Vukovar has been already covered by the Law on ASSC, but since it had suffered greatest devastations during the war and due to slow process of recovery a special law was passed aiming to speed up the revitalisation of the city.

many weaknesses, particularly the Law on Areas of Special State Concern and Law on Hilly and Mountainous Areas. Both laws suffer from incoherent, and, in many cases, non-existing solutions related to institutional, programming, coordination, evaluation and territorial designation issues. A different situation is in the case of Law on Islands, which introduced necessary mechanisms related to programming and coordination.¹³ Nevertheless, although a number of legal solutions exist at the moment, there is still no framework law on regional development which would ensure the necessary coherence.¹⁴

Map 1 Territorial coverage of ASSC, HMA and Islands



Areas covered by the mentioned three “development” laws are designated at the local level and, in some cases, even lower - at the level of the settlement¹⁵. Such a low geographical level of intervention has negative effect on policy efficiency and disrespects the previously identified significant disparities at county level. Furthermore, there are counties such as Požeška-Slavonia, Virovitica-Podravina, Sisak-Moslavina and

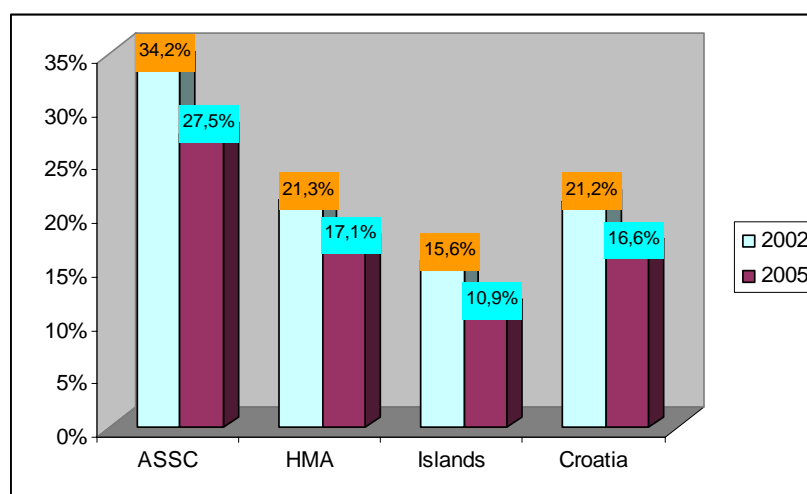
¹³ The Law on Islands envisages elaboration of Sustainable Island (i.e. groups of islands) Development Programmes and the State Island Development Programmes. Also, Islands Council has been established as a special advisory body of the Minister whose members include the representatives of central bodies of state administration, members of Parliament and representatives of islands.

¹⁴ Just for comparison, framework laws dealing with regional development and regional policy are in place in all new member states except Cyprus and Malta.

¹⁵ This is the case with Areas of Special State Concern, where in case of several local units, only some settlements are covered by the law. This is due to designation criteria based on the fact whether a local unit of part of it (settlement) has been occupied during the war.

others, where only few units are not covered by one of the laws, and these are in most cases urban centres which should serve as the growth poles of the county. Such approach is obviously not encouraging for the overall county development. Furthermore, Map 1 shows that significant number of local units in the two most western counties, Istria and Primorje-Gorski-Kotar are covered by one of the laws, although both county units have high above the average economic indicators. On the other hand, there are counties, such as Koprivnica-Krizevci, having much lower economic indicators, but where only few units have been covered by the laws. In their study on the proposal for a new categorisation of territorial units, Puljiz et al (2006) show that in case if new system with unique criteria's would be applied as a replacement for ASSC and HMA, 84 new local units should be designated as disadvantaged units and 34 currently included units should be excluded from governments' special support scheme. Out of these 34 units, the majority of units is placed in Primorje-Gorski-Kotar and Istria County. Such a result puts under question the applied criteria for designation of supported areas, particularly the ones for HMA. Furthermore, if the new system would be applied at county level, six counties would be categorised as disadvantaged ones. Another indication about how (un)successful has current approach been in reducing disparities at local level shows figure 2.

Figure 2 Change in unemployment rate at ASSC, HMA and Islands



Source: Authors' calculation on the basis of data from the Ministry of Finance on number of employed and Croatian Unemployment Service on number of unemployed population.

Despite the fact that fall in unemployment rate between 2002 and 2005 has occurred in all supported areas, the differences between supported areas and the country's average have remained rather constant. Figures indicate that there exist significant differences among the supported areas with respect to unemployment rate. ASSC indeed represent the most disadvantaged areas in terms of unemployment, while this is not the case with HMA which have around the average values. This finding puts in question measures aimed for HMA which in general correspond to the ones designated for ASSC despite

the fact that socio-economic situation in these areas is rather different.¹⁶ Islands face well below the average unemployment, but their special status and support from central level is understandable having in mind problems related to geographical isolation.

Present policy has paid little attention to institutional and organisational aspects of regional growth and competitiveness resulting in weak institutional capacities at all levels. A number of institutions act in the field of regional development in an uncoordinated and isolated way and in most cases with relatively limited resources at disposal. Table 1 comprises key institutions and assigns them to different stage of policy life cycle.

Table 2 Key actors in regional development policy at national and regional level

Functions of the policy life cycle	Central Government Institutions	Regional level
PROGRAMMING	Ministry of Sea, Tourism, Transport and Development–Department for Integrated Regional Development Central Office for Development Strategy and Coordination of EU Funds	County administration, Regional development agencies (RDA)
IMPLEMENTATION	Ministry of Sea, Tourism, Transport and Development–Department for Integrated Regional Development Fund for Regional Development Fund for Development and Employment Croatian Employment Service Croatian Agency for SME (HAMAG) Croatian Bank for Reconstruction and Development (HBOR) Other Ministries (Finance, Economy, Agric, Science, Social Welfare) State enterprises and utilities (such as Croatian Roads, Croatian Highways, Croatian Waters)	County administration, RDAs, Entrepreneurship centres, etc.
FINANCIAL MANAGEMENT AND CONTROL	Ministry of Finance State audit/ internal audit within ministries	State Audit/ internal audit within counties (to become functional)
MONITORING AND EVALUATION	-	-

¹⁶ Most important measures in terms of financial weight are various fiscal incentives for local population, companies as well as transfers to local budgets.

Ministry of Sea, Tourism, Transport and Development has been appointed as the body in charge of regional policy. Department for Integrated Regional Development within the Ministry is the key operational unit, responsible for policy design and implementation. In case of other institutions, only the Fund for Regional Development and Fund for Development and Employment and, partially, Croatian Bank for Reconstruction and Development have explicitly highlighted the regional dimension in the scope of its policy actions.¹⁷ The rest of the actors such as various ministries, agencies, state enterprises and utilities have important impact on regional development, but regional development is not of their primary concern, neither can the regional dimension be sufficiently recognized from their policy actions. At regional level many actors are involved in regional policy actions, out of which county administration and regional development agencies are the most relevant ones. In such a situation with significant number of involved actors both at national and regional level, the existence of a strong coordination mechanism is of particular importance. Unfortunately, this has not yet been the case. There is still no communication or coordination framework in place which would involve actors from central, regional and local level. The end result of such approach is the existence of many micro-policies supporting regional development at various levels in an uncoordinated and less efficient way. Such a situation presents a great disadvantage and a problem for regional policy in Croatia, since the successful implementation of regional policy is - due to its multi-sectoral nature and limited own resources - highly dependent on the coordination with sector ministries and agencies.

4.1 Regional policy instruments

Low consciousness about the modern regional policy is evident also in the case of policy measures. Grants, tax reliefs and direct investments into physical infrastructure are key instruments; while “soft”, programme based measures represent a negligible part of overall funding. The majority of measures are prescribed by the different laws, and, in most cases, take the form of fiscal incentive.¹⁸ There also exist other measures not based on legal acts, which are implemented by various funds, line ministries, agencies and other organisations. These measures range from subsidized interest rates and grants for businesses, guarantee schemes, scholarships, etc. Despite the increasing number of new development instruments appearing lately, transfers to local and county budgets still represent the major financing instrument. According to data from the Ministry of Finance on the central government’s spending in 2005, out of HRK 652 million of expenditures under section termed “Regional Development Programme”, 68,9% were spent on transfers to local units for capital investments, 28,6% have been classified as direct investments into reconstruction of schools and last 0,4% were spent on current transfer.¹⁹ Furthermore, HRK 226 million of expenditures under section

¹⁷ Under regional dimension is meant existence of systematic policy approach which takes into account specific regional socio-economic characteristics (such as high unemployment, or particular development potential in some area) and/or which would be participatory oriented with respect to regional and/or local actors.

¹⁸ Examples of other laws are Law on Profit Tax and Law on Income Tax which also prescribe various fiscal incentives for supported areas.

¹⁹ Term programme should not misinterpreted with the existence of real development programme in the sense of Structural Funds programming as such programme does not exist at the moment.

“Islands’ Development” can also be considered as part of regional policy spending. The structure of spending is very similar to the previous one, with highest expenditures for capital transfers (77,8%), followed with subventions to local companies (15%) and current transfers to local budgets (6,2%).²⁰ This funding represents only one part of total regional development funding. Namely, according to the same source, value of transfers for local budgets at ASSC in form of ceded tax revenues and grants has been estimated at around HRK 1 billion in 2004 (Ministry of Finance, 2004). This amount does not comprise value of the personal income tax returns at the expense of the central budget (instead of local budgets) as well transfers to local budgets in other supported areas, meaning that the overall amount of transfers is much higher. Data on regional aid provides a good indication about the current support for the business sector within targeted areas.²¹ Data for period 2003-2005 reveals that regional aid is constantly increasing, but the overall amount is quite small in comparison with investments into infrastructure and transfers to local budgets. Table 2 clearly indicates that regional aid represents only a minor proportion of total state aid and that tax reliefs represent the major type of regional aid. Strong increase in regional aid is primarily the consequence of a strong increase of tax reliefs, which have been more than doubled in the observed period, while subventions experienced only a mild increase. In comparison with transfers to local budgets, expenditures on regional aid are much smaller.

Table 3 Regional aid in period 2003-2005

Type	2003 (mln kn)	2004 (mln kn)	2005 (mln kn)	Index 05/03 (2003=100)	Share in total state aid in 2005
Subvention	27,5	34,9	33,8	123	0,5%
Tax relief	61,7	102,1	135,7	220	2,1%
TOTAL	89,2	137,0	169,5	190	2,6%

Source: Competition Agency, Report on State Aid in 2005

As already stated, there exist many other measures carried out by various sector bodies encouraging regional growth and competitiveness. For example, Ministry of Economy has designated many new types of measures aimed to increase national competitiveness (and therefore regional competitiveness) such as support for business zone development, training, cluster development, innovations, product development, etc. Yet, no attempt has been made for any territorial differentiation of these measures, despite the significant regional differences in terms of competitiveness.²² The additional problem is a very small level of funding for such type of measures. According to available data, total amount for the “Programme for Small and Medium Enterprises

²⁰ It is interesting to notice that 75% of total funding for “Regional Development Programme” in 2005 has been financed from international sources, in this case, the European Investment Bank and Council of Europe Development Bank. On one hand, this can be regarded as a positive attempt aimed to provide more funding for the lagging regions, but on the other hand it could be interpreted as a lack of domestic funding for regional development programmes.

²¹ Regional aid includes aid provided through following laws: Law on ASSC, Law on HMA, Law on Islands, Law on Profit Tax, Law on Investment Promotion, Law on Free Zones, Law on City of Vukovar

²² More detailed information about differences in competitiveness can be found in Competitiveness Report 2003, section on Regional Competitiveness.

Development” in 2005 was HRK 162 million, out of which the section “Competitiveness” received only HRK 16,9 million (Ministry of Economy, 2005). The average amount of individual grants within this section was only HRK 27.126 which is far too small amount for any meaningful effect to take place. Although most measures under the Programme for SME development are competition based, which is a positive change. Nevertheless, the problem remains with procedures for submitting project applications as well with application assessment rules, which have not been properly elaborated and as such are considerably different from the practice applied under Pre-Accession and Structural funds.

One of the rare positive examples of recognizing regional dimension by national development policy has occurred in case of new Law on Promotion of Investments passed in December 2006.²³ Part of the incentives, like grants to the companies for big investments and new employment, vary across the counties, depending on the county unemployment rate, thus providing more support for lagging counties. New approach in attracting investments is particularly important due to previously mentioned effect of favouring metropolitan and western regions by foreign and domestic investors.

In short, current approach with respect to designation and financing of policy instruments is not following latest trends in EU Member States. Structure of funding is particularly unfavourable. Too much emphasis is placed on transfers for local budgets and tax reliefs, while funding for instruments with stronger impact on regional competitiveness is insufficient. Relevant sector measures, have, with few exceptions, neglected regional dimension so far. Furthermore, since most funding is law based, competition based measures like grant schemes have not yet become a serious instrument of regional policy.

4.2 Most recent processes and initiatives at national and regional level

In October 2005 a draft of the National Strategy for Regional Development (NSRD) has been presented by the Ministry of Sea, Tourism, Transport and Development to the public. The strategy aims to ensure that all counties are enabled to contribute to the sustainable development and competitiveness of Croatia through coordinated approach of central government bodies and socio-economic actors across the country. This is planned to be achieved through addressing three key priorities (NSRD, 2006):

- Strengthening the development capacity of counties and wider regions across the country to utilise and manage their development potential (the County & Wider Region Development Programme)
- Supporting the "assisted areas" to contribute to sustainable national development and competitiveness (the Disadvantaged Areas Development Programme)
- Diminishing the negative effects of national borders on the development of counties (the cross-border and inter-regional cooperation programme).

The NSRD envisages several new instruments among which most relevant are development contract (DC), county development strategies (CDS) and county development agencies (CDAs). Development contract will formalise the commitment

²³ NN 138/2006

by central, county and local government to finance jointly the implementation of the Action Plan of an approved County Development Strategy. Development contract will take into account national as well as regional priorities within single county. There will be a development contract therefore covering every county. The second instrument, the CDS, is envisaged as the main planning document for the sustainable socio-economic development of each county elaborated as a consensus agreement between all relevant national, regional and local stakeholders. CDAs will be established in each county as a completely new institution or on the basis of already existing institution. In any case, a candidate for the status of CDA has to pass the accreditation process organized by the national authority in charge of regional policy. CDAs should be established as multidisciplinary teams that will promote and support the development efforts across the county, and will be in charge of continuous coordination of activities between central and regional level, as well as for horizontal coordination within the county (among the local units). The implementation of the above mentioned programmes and instruments also asks for the foundation of new bodies and structures at the national and regional level. NSRD envisages following bodies to be established: Committee for Regional Development Policy, Partnership Council for Regional Development and the County Partnership Council. These bodies should ensure close coordination of relevant actors at national and county level as well as the one between the national and county level actors. Finally, very important tool envisaged by the NSRD document, is the ex-ante evaluation. Namely, an independent ex ante evaluation is to be undertaken in the process of elaborating the County Development Strategy. The evaluators, and those responsible for the developing the CDS, are expected to work systematically through the various aspects of strategy to ensure its relevance and appropriateness to the needs of the county. Together with the Strategy, a proposal of the Law on Regional Development has been elaborated, with the aim to provide the necessary legal basis for NSRD proposals. Still, neither the Strategy nor the Law have been officially adopted by the responsible institutions.

In the meantime, while process of regional policy reshaping at central level is still waiting to be officially approved, a clear pressure is present from the part of the Croatian counties to become more involved in the regional development process has become evident. This is, among other, confirmed through the huge interest of county and local units in preparation of development strategies in participatory manner and also through increasing number of the county development agencies. Twenty out of twenty-one counties have by now prepared a County Development Strategies (CDS) or an equivalent county development planning document. Furthermore, seventeen county development agencies have been established so far. It is expected that each county will soon have its development agency. Some of the existing agencies have significantly raised their capacity in the past several years with respect to development programming and project management. An increase in the number of available EU funded grant schemes has certainly helped them to improve the necessary skills related to project application preparation as well as project implementation. Taking into account these and other developments at county and local level it can be concluded that some parts of NSRD are already being implemented despite the fact that the NSRD and the Law on regional development have not yet been officially adopted.

5. IMPACT OF ACCESSION PROCESS ON REGIONAL POLICY

Another important aspect to consider is the effect of European integration on designation of regional policy and other development policies in Croatia. On the one hand, once becoming a full member state, the funding opportunities for regional policy will increase considerably and this can be considered as a direct effect of the integration. On the other hand, the adjustments which have to be undertaken in order to effectively manage Cohesion policy funding are wide-reaching and quite demanding; they take substantial time and effort and their impact can be considered as an indirect effect of the accession process. Adjustments related to reaching compliance with Cohesion policy are carried out within the negotiations of the Government of Croatia with the EC in Chapter 22: Regional Policy and Coordination of Structural Instruments. There is no *acquis communautaire* with respect to regional development. Chapter 22 of the *acquis* is primarily concerned with the steps that must be taken to effectively manage the Structural Fund instruments. The matter of a country's national regional policy is considered thus a matter of subsidiarity and is not the subject of negotiation process as long as it complies with other relevant Community policies like Competition policy and others. While such approach is understandable having in mind the differences and particularities of individual countries, in case of Croatia, leaving current regional policy aside of the adjustment process could have serious negative repercussions on already low policy effectiveness. Without modernizing and adjusting current regional policy to Cohesion policy principles, Croatia could end up having two parallel systems of supporting regional development based on entirely different logic and practice. In that case, significant problems with implementation of such different policies could be expected at all levels, from policy-makers up to policy beneficiaries. That is why the case of designating a new national regional policy compliant with Cohesion policy rules and practice is of particularly importance for Croatia. Also, having such policy would surely increase the overall absorption capacity of Croatia for managing Structural Funds which is quite important.

The process of adjustment has also imposed the obligation regarding the defining of wider regions, i.e., introducing the NUTS 2 regions in Croatia, which represent a territorial level at which Cohesion policy is mainly implemented.²⁴ With respect to management of EU pre-accession funds NUTS 2 level does not play an important role, as the management in the pre-accession phase is undertaken exclusively at national level. After the accession, i.e. in the forthcoming programming period 2013-2020, Croatia will be in position to decide whether to keep centralized management approach or to introduce more regionalised approach, for example with SF management placed at NUTS 2 level and with the an involvement of regional actors in the management process. Involvement of regional institutions in SF management is a very important issue. Bailey and De Propris (2002), for example, claim that "...SF funding *per se* did not induce economic convergence, rather regional participation was and still is a crucial factor for regional development". Experiences of new member countries regarding involvement of regional actors are different. In the first phase after accession from 2004 to 2007, management of SF has been quite centralized in all new member countries with very limited role for regional actors. The latter have been

²⁴ NUTS 2 regions eligible for Convergence objective should receive 82% of total funding for 2007-2013 period.

engaged mainly on activities related to preparation of project proposals and their implementation, while programming, selection of projects and their monitoring have been exclusively managed by central level institutions. For the programming period 2007-2013 new member states have taken different approaches, ranging from mixed central-regional approach in case of Poland, Czech Republic to strongly centralized one in Baltic countries and Slovenia (EPRC, 2006). Still, in majority of countries role and contribution of regional actors is gradually increasing along with the increase in their institutional capacity. Similar process can be expected in case of Croatia. At the moment capacity of regional structures to participate in SF operations is quite low. There are some counties, like the ones in County of Istria and Varaždin, which have been quite active and successful in preparation and implementation of EU funded projects, but majority of counties are still lacking the necessary capacity to effectively participate in SF operations.

From point of view of programming, Croatia has already prepared a range of programming documents or is in the middle of the preparation process, quite relevant from point of view of the regional policy. These are:

- Strategic Development framework 2006-2013: this is an overarching national development planning document, which is based in part on sectoral strategies elaborated by line Ministries; the document was prepared by the Central State office for Development Strategy and adopted by the government in August 2006.
- Strategic Coherence Framework (SCF): this document is the planning document for the IPA components III and IV from 2007 and is the precursor of the National Strategic Reference Framework document under the Structural Funds. It will be complemented by respected operational programmes for each of the designated sectors involved. These are Operational Programmes (OPs) for Transport, Environment, Regional Competitiveness and Human Resource Development.
- Operational programmes for Cross-border cooperation with EU member states and non-member states
- Operational programme for Rural development

Related to overall institutional structure - the State Secretary of the Central Office for Development Strategy and Coordination of EU Funds (CODEF) acts as national IPA coordinator. Furthermore, operating structures (future managing authorities under the SF operations) which are to manage and implement Operational programmes have also been agreed and are presented below together with funding during 2007-2010:

Table 4 IPA components

IPA component	Operational programme	Body in charge	Funding 2007-2010 (million EUR)
I – Transition Assistance and Institution Building	-	CODEF	178,1
II – Cross-border Cooperation	For each neighbouring country	CODEF	56,5
III – Regional development	1) Transport	Ministry of Sea, Tourism, Transport and Development	198,7
	2) Environment	Ministry of Environment Protection, Physical Planning and Construction	
	3) Regional Competitiveness	Ministry of Economy, Labour and Entrepreneurship	
IV – Human resources Development	Human resources development	Ministry of Economy, Labour and Entrepreneurship	53,7
V – Rural Development	IPARD	Ministry of Agriculture	102,9

Total value of IPA assistance until 2010 is estimated at EUR 589,9 million or annually 147,5 million. The relative small amount of funds at disposal suggests that no major direct impacts on development can be expected during pre-accession phase. Still, the importance of EU funding lies more in those indirect effects coming from introduction into Croatian practice a new style of development management and development funding and possibilities for learning from actors in other member states. If national and regional structures will be able to exploit and implement the new knowledge and practice in an appropriate way into national development policy operations, than the added value of accession process will be much higher. In that respect we quote the following words of J. Bachtler: “Managing Structural Funds programmes presents formidable challenges..... One of the most valuable aspects of the past 15 years is the scope for learning about best practice in SF management across time from one programming period to the next, and through the exchange of experience among Member states and regions” (Bachtler, 2005). From the point of view of balanced regional development, learning and overall capacity building activities will be especially important for the lagging regions due to their currently low absorption capacity. Otherwise, majority of funding could be directed to most advanced regions, thus further contributing to regional unbalances.

6. RECOMMENDED STEPS FOR IMPROVING EFFECTIVENESS OF NATIONAL REGIONAL POLICY

The most urgent step for creating a coherent and modern regional policy is the setting up of the necessary legal and strategic framework, i.e. the adoption of the National Strategy for Regional Development and Law on Regional Development. Their adoption would create the necessary preconditions for the fulfilment of key regional policy goals as set in NSRD - the decrease of regional disparities and strengthening of regional competitiveness. In order to reach these goals, current approach and practice needs to be changed radically. For the start, current regional policy is completely missing strategic dimension. Majority of existing measures are not connected to any development programme; instead they are either law-based or depend on discretionary power of the central level institutions. Such approach should be changed. A programme based framework with a precise set of medium and long-term development objectives should be set as a basis for designation of specific measures. Preparation and implementation of the development programmes needs to be accompanied with strict evaluation practice in line with EU approach. Regular reports on the impact of implemented programmes and measures are of particular importance. Furthermore, the overall programming framework should be embedded in a wider negotiation and coordination framework in which all actors, central, regional and local including as well the socio-economic partners will be in opportunity to put forward and discuss options and solutions for supporting regional growth and competitiveness. Discussion on regional implications of sector-based policies is also important due to high impact on regional development. The proposal from the NSRD on introduction of the multi-annual financing agreement (“development contract”) between central and regional level based on the process of negotiation between national and regional level would surely help such a framework to become functional.

A change in the territorial approach is also necessary. Current focus on local level is, firstly, in sharp contrast with the significant disparities identified at regional level and, secondly, negatively affecting policy efficiency. Nevertheless, there still exist significant disparities at local level which should be taken into account. Therefore, a new approach which would include both county and local level could represent an optimal solution. Also, present criteria’s for designation of supported areas are too diversified and should be replaced with a single set of most relevant socio-economic indicators. This would bring more coherence and provide policy makers with a more reliable tool for tackling regional disadvantage – as well as measuring the reduction of disparities. Furthermore, current policy has concentrated exclusively on lagging areas and areas with special development needs such as islands, while role of growth centres – i.e. urban areas, has been completely neglected. This should be changed by introducing new development instruments covering role of urban areas in overall development of the region and a whole country.

Changes in the selection and funding of policy instruments should be of particular concern, as current measures were not successful. Existing instruments should be complemented with those more focused on exploiting local and regional strengths and potentials than reducing existing handicaps as it is the case today. Measures targeting non-tangible factors, such as regional innovation potential, business environment, local and regional capacities for managing development, quality of regional education capacities, business networking, cooperation of business and

educational sector, human resource development, development of the information and communication technology on the local/regional level, etc. should receive major attention.²⁵ Furthermore, current approach lacks competition based incentives. Grant schemes via public tender and based on strict evaluation procedures and system of financial awards for most successful regions are usual instruments of Cohesion Policy and national regional policies in member states.²⁶ Application of these experiences in Croatia would surely help in promoting the competition spirit and to improve the policy efficiency. Besides designation of new policy instruments, regional policy actors should take more into account the fact that available resources at disposal for regional policy are quite small and absolutely insufficient for reaching regional policy objectives. In that respect, the impact of sector policies with respect to regional development is crucial and therefore it is recommended that regional policy actors provide initiatives on contribution of sector measures to regional policy objectives. Sector policy makers should take into consideration regional impacts of their decisions and in coordination with regional policy makers should try to find an optimal solution.

As to the involvement of local and regional actors in the regional policy processes, it is already indicated that their role should be increased and put in a formal framework. Participatory approach to elaboration of county development strategies can surely serve as a useful experience, which needs to be used and further developed. In this regard, county development agencies will have a very important role to play as potential coordinators of the relevant actors in their regions. Still, the competences and duties of the development agencies will need to be further defined and developed in cooperation with central level institutions in order to achieve more harmonised and coherent capacity at regional level. Close cooperation of county and national structures and designation of efficient vertical coordination are of highest importance, particularly in case of agreement about the content of “development contract”. In that respect, NSRD already envisaged that central level institution in charge of regional policy plays a role of a facilitator between sector level and county level bodies during negotiations on the content of the development contract and later during implementation phase.

The accession process brings an entire new set of challenges into the national regional policy framework. Accession process will surely increase the pressure on institutional capacity at all levels, meaning that much more attention should be paid to capacity building programmes, especially in case of lagging regions. The problems could appear if Croatian policy-makers decide to keep current national approach in supporting regional development without any attempt to adjust it and connect it properly to SF management in Croatia. On the other hand, introduction of Cohesion policy principles such as programming, participation, concentration, evaluation and others into Croatian policy practice would significantly improve its effectiveness and create synergy with SF operations in Croatia.

²⁵ Still, when introducing new instruments it is necessary to take into account existing local and regional particularities and not to make mistake with introduction of too advanced policy for local and regional environment. Hospers i Bennenworth (2005) are pointing on bad experiences with introduction of too advanced regional policies for the environment and call of middle path which fits advanced development trends worldwide into local and regional tradition.

²⁶ According to Structural Funds regulations three percent of the Structural Funds allocations to Member States under the Convergence and Regional competitiveness and employment objectives may be placed in a national reserve for rewarding performance.

7. CONCLUDING REMARKS

Latest trends in regional policies of EU member countries have not been yet recognized by the Croatian policy-makers. Croatian regional policy is a very static policy, which experienced only minor changes since its establishment in late 1990s. It is conducted in an old-fashioned manner, through numerous fiscal incentives and transfers from central to county and local budgets. On the other hand, whole range of instruments such as programming, coordination, partnership, evaluation and others still waits to be incorporated into policy practice. Such low-developed and inappropriate policy lies in sharp contrast with the existence of significant regional disparities. Regional policy lacks strategic dimension with set medium and long-term objectives and with necessary policy mechanisms which would bring various actors into the position to think strategically and coordinate among them. The solution of this problem is not an easy one, as similar weaknesses can be found in case of much stronger sector policies. As for the relation between regional policy and sector policies, this is an issue of particular importance for successful regional development, which has been much neglected so far. For the start, establishment of a coordination mechanism where present and potential effects of sectoral policies would be discussed and evaluated would be highly beneficial. Focus of current policy entirely on local level has resulted with further negative consequences on policy efficiency. Evidence on further widening of development gap between the counties makes the call for policy change even more urgent.

In last few years some steps have been undertaken in order to improve the situation. National Strategy for Regional Development and Law on Regional Development have been drafted providing many missing elements necessary for transformation of regional policy into a modern policy, compatible to Cohesion policy principles. However, both documents still wait to be adopted, without any signals when adoption can be expected. At the same time, at regional and local level many bottom-up activities have taken place such as establishment of regional development agencies and elaboration of county development strategies. The capacity of regional actors, particularly in some advanced counties, to designate and implement development policies has increased, but capacity building activities are still necessary. The key problem remains at national level, as in absence of coherent overall policy framework regional initiatives are faced with numerous obstacles. Most obvious case represents implementation of county development strategies which highly depend on the (financial) support from the central level. In the absence of a multi-annual financial framework imposed by central level, and taking into account very restricted county and local budget revenues their successful implementation can not be expected.

Accession process could represent a new opportunity for setting up more systematic and more effective approach to regional development. Some important activities that have already taken place, such as elaboration of National Strategy for Regional Development, have been funded through the pre-accession programmes. With further advancement in accession process and particularly after becoming member country, more direct impact of EU funding on regional development can be expected. Still, the importance of accession is not only about new funding opportunities. More relevant question is how much will current policy-makers at all levels learn from the experiences member states with participation in Cohesion policy as well as from their national regional policies and how much of it will be successfully applied to the

Croatian development policy. If policy-makers recognize this opportunity, than many reforms of current policy can be expected which should improve its efficiency and effectiveness. Other possibility could be, that we end up having two parallel systems of supporting development, one based on EU rules and practice and second one, based on old-fashioned instruments and with many missing elements characterising modern regional policy. We hope this will not be the case and that Croatia will soon have a modern regional policy, able to reach objectives as set in NSRD, and able to significantly contribute to successful management of SF in Croatia.

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