

CO-FINANCING OF EUROPEAN UNION FUNDS – ONE OF THE FACTORS FOR SUSTAINABLE DEVELOPMENT OF LATVIA'S REGIONS

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Abstract

In order to achieve the objective – to evaluate sustainable development opportunities of Latvia's regions based on co-financing of European Union (EU) funds, the allocation and usage of EU funds within the division by regions in 2004-2006 and the framework of National Entrepreneurship Support Programmes were analysed. The basic principles of EU regional policy and Latvian development priorities as well as possible regional development evaluation methodology applied were examined. The territory development indexes for the planning regions elaborated by the State Regional Development Agency were analysed with the aim to describe the current situation in the planning regions.

The problem of the research – the EU co-funding has been provided to foster balanced development of the regions, but in practice it proves that economically advanced regions attract more EU co-funding while less developed regions do not receive sufficient funding thus resulting in retained or even increased socio economic disparities instead of combating those disparities.

Taking in consideration that the impact of co-financing on the region's development could be evaluated not earlier than in 2-3 years' time after the investment, it is crucial to begin the research and discussions at the present moment to prove that no development expectations can be made if no or small amount of funds are invested.

Key words: sustainable development, regional policy, entrepreneurship, EU co-funding.

Introduction

The objectives of Latvian regional policy are in line with European Union sustainable development strategy aimed at provision of economic welfare and social equality. One of EU priorities is cohesion, it means diminishing of socio economic disparities between EU member states, because major disparities hamper the development of both - EU in whole and each country and region individually, even the most wealthy ones. If regional policy instruments are not applied, the disparities between economically most advanced and most backward regions will retain and increase.

The problem of the research – the EU co-funding has been provided to foster balanced development of the regions, but in practice it proves that economically advanced regions attract more EU co-funding while less developed regions do not receive sufficient funding thus resulting in retained or even increased socio economic disparities instead of combating those disparities.

Goal of the research: to evaluate sustainable development opportunities of Latvian regions based on co-funding of European Union (EU). **Tasks of the research** are twofold: 1) to analyse co-funding of European Union (EU) to support entrepreneurship development under European Regional Development Fund (ERDF) from 2004 to end 2006 administered by Latvian Investment and Development Agency (LIDA) by the means of National Support Programmes as well as actual allocation of EU co-funding by regions; 2) to examine regional development evaluation methodology.

Methods of the research: the basic research used in paper is monographic method, depending on analysis of sources gathered from monographs, Latvian State documents and State Agencies and the Internet. Other methods applied: inductive research approach which allows generalization of collected and analyzed information; interaction of analysis and synthesis for evaluation, compilation and interpretation of specific data; statistical; graphic method.

Regional development research methodology

The existing worldwide **Regional development theories** are different therefore it is difficult to choose only one to base analysis of the specific regions on. It is possible to use, for instance, *Regional Economic Growth Determinants* (in this case these are the factors dependent on something) belong to the group of *Space Mobility Theories*. Economic growth can be defined as (V. Bugina, 2004): 1) actual social product increase:

$$Y_1 > Y_0 ; \quad (1)$$

where

Y_1 = actual social product in the time period $t = 1$;

Y_0 = actual social product in the previous time period $t = 0$;

2) or as actual social product increase per capita:

$$\frac{Y_1}{B_1} > \frac{Y_0}{B_0} ; \quad (2)$$

where

Y_1 = actual social product in the time period $t = 1$;

Y_0 = actual social product in the previous time period $t = 0$;

B_1 = number of inhabitants in the time period $t = 1$;

B_0 = number of inhabitants in the previous time period $t = 0$.

The concept *social product* includes not only economic indicators but also infrastructure, political and social system and other values, therefore its practical efficient calculation is complicated. Besides, applying the formula (2), it is not possible to talk about the growth if the social product has increased less or equally to the number of inhabitants.

The analysis of the regions can be conducted with integrated methods, combining *Location Theories* and *Regional Growth and Development Theories*. One of the indicators used in Latvia to characterize economic growth is increase of absolute gross domestic product (GDP) per capita. The disadvantage in this case - the issue of welfare increase is being neglected.

In order to analyze impact of EU co-funding on regional development, the methodology is needed to conduct such a research. Penetrating the experience of EU member states, it can be concluded that there is no single approach and each country makes efforts to research the issues individually. Until now the only large scale research on impact of Structural Funds (SF) on regional development conducted in European Union is **project ESPON 2.2.1**. (ESPON, 2005).

The focus was on the programming period of 1994-1999 in EU-15 countries, mainly due to the fact that it was deemed too early to judge the final effects and in particular, impacts, of the 2000-2006 activities. The project concentrated on the mapping of the Structural Funds and assessing their contribution to the aims of spatial development policies, with particular emphasis on territorial cohesion and polycentric development. The study has sought to establish the possible links between Structural Funds intervention and the promotion of territorial cohesion and polycentric development.

The main indicators of regional development were increasing GDP overall and per one person, but also indicators: demographic level, unemployment and other economic parameters were analysed. Conclusions of research the project ESPON 2.2.1 are: there are two main ways in which the Structural Funds may influence spatial development:

- 1) there is potential inherent in the spatial nature of the funds themselves and there is the potential expressed in the area designation process. By deciding which areas are to be covered, by what types of interventions and by what intensity of intervention, the main channel of influence within spatial development is defined. In area designation the issue of territorial cohesion at both the *macro* and *meso* levels could be addressed. In theory, area designation could be contributed to *micro* level issues as well, but approach where EU member states and national and regional stakeholders influence *micro* level priorities is probably more realistic. Instead of area designation specifically targeted to polycentric development, a horizontal approach to the issue seems more promising. Area designation paying attention to functional urban areas, e.g. not splitting those, would increase the possibility of contributing to polycentric development.

- 2) The form of intervention also influences spatial development. Some policy forms may have more explicit spatial impact than others. In general however, policy interventions may take two main forms: (1) cushioning the adverse effects of investment or disinvestment decisions, and (2) speeding up investment decisions. The effect in this sense is likely to be more significant in regions/countries where the national funding available targeted at strategically important infrastructure investments is scarce.

If we analyse impact of project financing on entrepreneurship we can use the methodology of the **International Finance Corporation (IFC)**, which was one of the pioneers of project finance in developing countries more than 45 years ago, and project finance remains an important core of IFC's activities nowadays. IFC's mission is to contribute the World Bank Group's overall purpose of reducing poverty and improving living standards by playing a leading role in the development of a sustainable private sector. Just in 90-ties of the 20th century IFC, which has a committed portfolio exceeding \$11 billion in loan and equity investments in over 230 green-field projects in 69 developing countries (Argentina, Hungary, China etc.) all over the world (Project Finance., 1999). Three important principles guide IFC's work: the business principle, the catalytic principle and the special contribution principle.

Nevertheless the methodologies mentioned above should be analysed more in-depth to make conclusions about the possibilities to apply them in situation of Latvia.

Results and discussions

Situational analysis based on comparison of Riga and Latgale regions

To ensure national sustainable development, it is important to ensure development of both - individual smaller areas – parishes, counties, districts - and regions, but then the legal and material basis is required to provide this. The objectives of Latvian regional policy are defined in Regional Development Law (in 2002) and Regional Policy Guidelines (in 2004), and they are as follows: bringing national and regional development level nearer to the level of European states; competitiveness increase; provision of equal value living, work and environment conditions to people all over the country; creation of equal value preconditions for entrepreneurship and others.

If comparing an important macro-economic indicator – gross domestic product (GDP) per capita in regions of Latvia, it can be concluded that regional disparities had been increasing within the time period 1998 to 2002. For instance, GDP per capita in Riga Region in 1998 exceeded Latgale Region indicator 2.4 times, in 2000 - 2.8, but in 2002 – even 3 times. Since 2003 a vague tendency of diminishing disparities can be observed (2.7 times), but in 2004 – 2.6 times (according to unofficial data). As EU SF co-funding was available since 2004 but, as mentioned before, it was not marked for each of the regions, it is most likely when comparing regions of Latvia by GDP per capita, the disparities will not diminish rapidly. Nevertheless the final conclusions can be made only after the analysis of the official data of the years 2004 to 2006. When analyzing amount of non-financial investments from 1999 to 2004, it can be concluded that they have increased in all the planning regions but regional disparities have remained. For instance, the largest amount of non-financial investments per capita in 2004 was in Riga Region – 1190 LVL, which compared to 1999 increased by 650 LVL per capita. However the smallest indicator in 2004 was in Latgale Region – 389 LVL, which is 2.3 times less than average in the country (880 LVL) and 3.1 times less than in Riga Region. Besides, the fact that regional disparities between Regions of Riga and Latgale in 2004 have remained on the level of 1999 is quite significant.

The precondition of national economic development is improvement of entrepreneurship environment but in its turn one of the indicators characterizing entrepreneurship development is the number of economically active enterprises. The number of economically active enterprises and companies (except peasant and fisher farms) in the time period 1999 – 2004 increased by 13.8 thousand or 36.7%. Analysing these indicators by the planning regions, it can be concluded that in Riga Region it increased by 49.7%, but in other regions - by 11-16%. The lowest increase was in Latgale Region – only 11.3%.

In the time period from 1999 to 2004 the number of economically active enterprises and companies per 1000 inhabitants on average in the country increased by 6.5 enterprises, including – in Riga Region by 11.4, but in Kurzeme – by 2.4, Vidzeme – by 2.0, Zemgale – by 1.8 and Latgale – by 1.6 enterprises.

Regional disparities have been increasing each year, for instance, in 1999 the number of economically active enterprises and companies in Riga Region per 1000 inhabitants was 2.4 times larger than in Latgale Region, in 2004 – already 3.1 times larger, but the tempo of the indicator's increase in Riga Region in the period of six years has been 7 times faster than in Latgale Region.

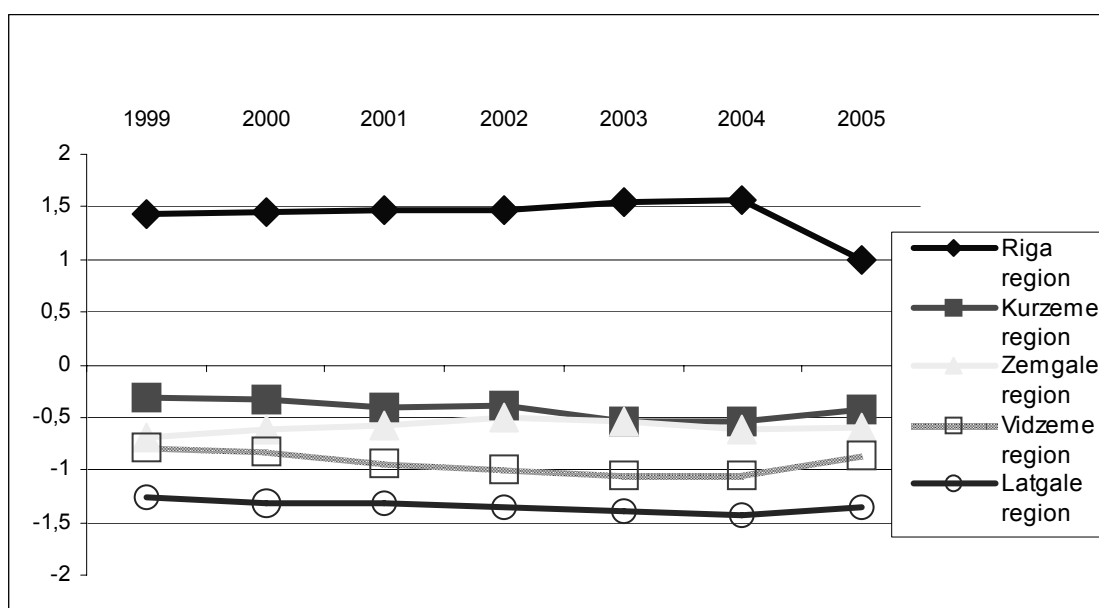


Figure 1. Territory development indexes of the planning regions in Latvia from 1999 to 2005

Source: data of State Regional Development Agency, 2005, 2006.

To characterize the situation in the planning regions of Latvia, the territory development indexes (TDI) elaborated by State Regional Development Agency (SRDA) should be looked at Figure 1. These indexes are used to ensure national scale programmes, including definition of specially assisted areas, differentiation of state support rate, division of state budget subsidies and municipal funding for parishes, towns, counties and districts in the projects co-financed by EU structural funds (not only in specially assisted territories).

According to the territory development index, Riga region is in the first place but Latgale Region takes the lowest position – the fifth place. Thus, if this would be taken as the basic indicator when allocating EU co-funding, Latgale Region would receive the major part, other regions – respectively smaller parts, but Riga Region would receive the smallest funding.

Amount and the main conditions of European Union co-funding

After Latvia's accession in European Union in 2004, our country had wider access to EU co-funding, including the means of the Structural Funds. National Development Plan for the period 2004 – 2006 or Single Programming Document (SPD) defined national development priorities and activities with the planned EU EF co-funding allocation of 625 568 826 EUR.

As Objective 1 Programme at EU level is foreseen to diminish unfavourable disparities between European regions and is aimed at NUTS 2 level territories, which include Latvia, SPD was not focused on solving the problem of territorial disparities in the country and it did not include separate funding for regions. Nevertheless implementation of SPD should have included a system which would be able to strategically reflect the situation in implementing SPD measures in the regions at NUTS 3 level – in the six statistical regions in Latvia or in nationally approved five planned regions.

The actual situation shows that due to the complexity of EU SF management information system, established by the Ministry of Finance (leading authority in managing EU Structural Funds), the reports on the situation in territorial perspective could not be developed. That is why the situational monitoring still is done either by specific studies or by initiatives of the administrating institutions on individual activities.

National support programmes to entrepreneurs with EU co-funding

National support programmes for the period 2004-2006 administered by Latvian Investment and Development Agency envisaged total investments of 145.55 million LVL (int.al. 109.9 from EU ERDF, 36.6 from the state) for creation of new production units, modernization of existing companies, advice, training of labour force and others. In 2006, LIDA received project applications from 821 entrepreneurs with request for funding from EU Structural Funds, and the total amount requested was 108,4 million LVL, but the contracts were signed with 614 projects.

Compiling publicly available LIDA information, 468 contracts signed with the entrepreneurs in 2006 in the total amount of 54 880 828 LVL (see Table 1) were analysed. Sub-programme 1.2. „Business development according to the requirements of international standards” under National support programme “Support to modernization of business infrastructure” was the most appropriate for the entrepreneurs and thus the most demanded. In spring 2006, LIDA announced the second call for applications and there were even queues to submit the project applications as well as strong discussions about existing mechanism of distributing EU funds. National government in its turn had to allocate additional funding under this programme to support all the approved business projects. In the sub-programme 1.2 was defined the allowed assistance rate (amount of funding in percentage for eligible expenditure per project) in all the territory of the Republic of Latvia and it was up to 65% of the eligible expenditure for small and medium size companies per project, but for large ones – up to 50%. When analysing the criteria set up for financial statements of the applicant companies (consisting of the balance, profit-loss statement, cash flow statement, long-term investment flow statement) for the last period before submission of the project to LIDA, it can be concluded that they are differentiated by regions. For instance, the indicators before implementation of the project had equal requirements for all the applicant companies (Guidelines of LIDA, 2004):

- 1) Rate of own capital against total assets = Own capital / Total assets $\geq 0,2$ (3);
- 2) Liquidity ratio = Current assets / Short – term liabilities $\geq 0,9$ (4);
- 3) (Profit after taxes) + (Amortization * 50%) ≥ 0 (5).

Table 1

EU Structural Funds for entrepreneurs under National Support Programmes according to the contracts signed in 2006, LVL

Nr.	National Support Programmes and sub-programmes	Total (LVL)
1.	Support to modernization of business infrastructure	49 563 800
1.1.	Creation and reconstruction of connections for infrastructure development	3 176 046
1.2.	Business development according to the requirements of international standards	44 954 689
1.3.	Creation of shared infrastructure	1 433 065
2.	Support to development of new products and technologies	1 900 976
3.	Support to advice and participation of companies in international exhibitions, trade missions	1 766 591
3.1.	Advisory services	1 258 356
3.2.	Participation of companies in international exhibitions, trade missions	508 235
4.	Support to training, re-qualification, further education of labour force	1 649 461
	Total funding:	54 880 828

Source: own calculations based on data of Latvian Investment and Development Agency, 2006.

Data of Table 1 show that under the first national support programme “Support to modernization of business infrastructure” the contracts were signed with value of 49.56 million LVL or 90% of total amount. This also includes sub-programme 1.2 – 44.95 million LVL or 82% of total amount. Entrepreneurs have used only small part of financing provided in other programmes: Creation and reconstruction of connections for infrastructure development (sub-programme 1.1) – 5.8%, Support to development of new products and technologies (programme 2) – 3.5%, Support to advice and participation of companies in international exhibitions, trade missions (programme 3) – 3.2%, Support to training, re-qualification, further education of labour force (programme 4) – 3%.

Analysing the balance sheets of 2005 and 2006 of several small and medium size companies in Latgale Region, it can be concluded that entrepreneurs in many cases could not submit their projects due to the reason that the mentioned above indicators did not meet the requirements (formulas 3, 4, 5). Not denying the need for criteria is set up for evaluation purposes of project applications, the major differences in financial situation of the companies in various regions of Latvia should be taken into account as well as differentiated rates – criteria before and after project implementation should be set up.

Figure 2 reflects the results of the analysis of the funding under national support programmes to entrepreneurs based on the signed contracts in 2006 by regions. It can be concluded that the major part of funding is obtained by entrepreneurs from Riga region (28%), followed by entrepreneurs from Kurzeme (23%), Zemgale (21%) and Latgale (19%) but relatively small number of entrepreneurs from Vidzeme Region applied for funding – only 9%.

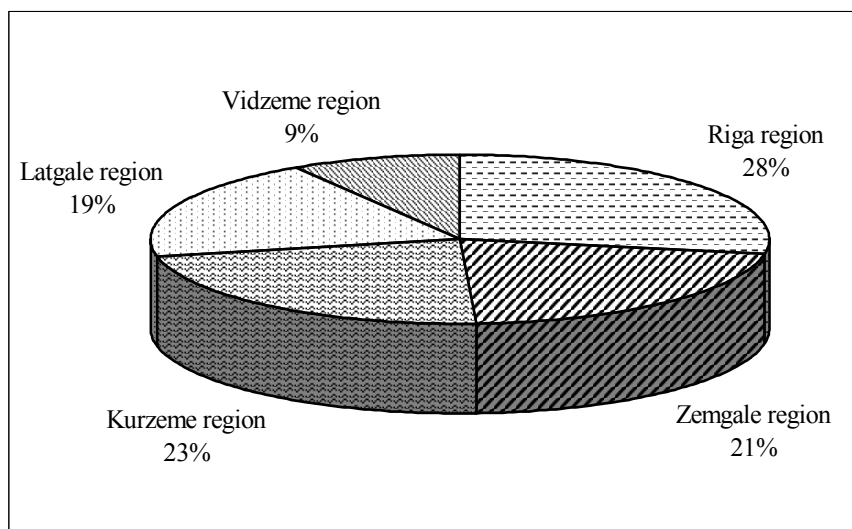


Figure 2. EU Structural Funds for entrepreneurs – national support programmes in planning regions of Latvia in 2006, %

Source: own calculations based on data of Latvian Investment and Development Agency, 2006.

As mentioned before, the specific division of funding by regions was not planned. As a result the entrepreneurs from economically advanced Riga Region were more active and they succeeded in using their intellectual and financial resources in project development. The conclusion can be made, that on governmental level there is lack of more goal-oriented and thought-out policy for development of project evaluation criteria, so they would be more favourable for regional entrepreneurs. In regional level the information about EU co-financing possibilities should be more active, accessible and understandable in order to enhance the possibilities of entrepreneurs for project development.

EU public co-funding by Latvian regions

The division EU public co-funding (including Cohesion Fund) in the amount of 371.7 million LVL or 67.5% of the planned total amount according to the data of the time period from 01.05.2004. to 01.01.2006. is presented in Figure 3. It can be concluded that economically advanced Riga Region has received major part of funding – 40%. Though economically backward Latgale Region has received minor funding – 11%. Zemgale followed by Kurzeme Region have received a little more.

The division of absolute funding from EU Structural Funds points at the direct relation between territory development level and amount of the funding attracted – the highest territory socio economic development level, the most funding received. So EU SF co-funding is not divided by Latvian regions accordingly to, for instance, regional development index or any other objective economic criteria which in its turn negatively affects even and balanced development.

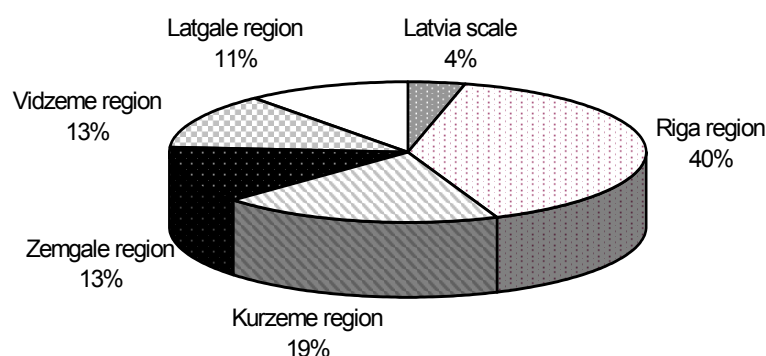


Figure 3. Actual division of public funding under SPD territorial activities by planning regions on 01.01.2006, %

Source: *Evaluation of EU Structural Funds impacts on Regional development in Latvia, 2006.*

Comparison by funding amount per capita or comparative indicator is more objective than absolute indicator. On average it was 148.40 LVL per capita. Most of funding per capita was in Kurzeme Region (205 LVL) and Vidzeme Region (187 LVL). In Zemgale Region it also exceeded the average of Latvia (154 LVL). In Riga Region - 123 LVL, but the smallest amount was in Latgale Region – only 103 LVL per capita. There is two times difference between the highest and lowest indicator.

Nevertheless it is not correct to analyse these absolute and relative indicators in the beginning of 2007 because they reflect the situation of 01.01.2006. but in 2006 the projects were implemented with value of about 170 million LVL or 30% of planned funding. Therefore the initiated studies on usage of EU SF co-funding for entrepreneurship development and provision of sustainable development of regions of Latvia should be continued more actively than until present time, more extensive scientific development and discussions should be made in order to prove that the financing should be invested in less developed territories.

Conclusions

1. 'In order to ensure even development of regions of Latvia and to diminish disparities between different territories, regional policy should be implemented not only *on paper*, but also in practice, by assigning more financing to the less developed territories. In that case EU SF co-funding can become a feasible assistance to combat regional backwardness.
2. Due to short time period and lack of sufficient information, a clear relation between development indicators of individual part of the territory and respective funding cannot be distinguished. Nevertheless the data show interconnection that the lagging behind regions attract minor funding from the view of both - absolute and comparative values, and there are threats that slow development and increasing disparities may still take place in comparison with economically more advanced regions. At the same time - it cannot be declared that economically the most advanced regions do not attract the major part of EU funding.
3. Although the impact of co-financing to the region's development could be evaluated not earlier than in 2-3 years' time after the investment, it is crucial to begin the research and discussions at the present moment to prove that no development expectations can be made if no or small amount of funds is invested.
4. There is a need for single EU project recording system as well as wider and more regular studies on usage of EU co-funding in overall country and in individual regions, development of appropriate methodology, and, possibly, creation of a particular research structure.
5. Most of all entrepreneurs used National Support Programme "Support to modernization of business infrastructure" - 90% of total amount and most of them were in Riga Region.
6. In order to promote entrepreneurship development and rise interest of people to work in remote

regions, national support policy is needed, for instance, such instruments as inhabitant income tax relieves, enterprise income tax relieves for the part of the profit that is invested into enterprise, etc. Taking into account significant differences in financial situation of small and medium size enterprises in different regions of Latvia, differentiated rates should be introduced for the project evaluation purposes depending on territory development index of the location of the enterprise.

7. The appropriate and effective usage of EU co-funding, regular analysis and adjustments of the plans according to the situation should become one of the public administration priorities in order to accomplish the main task to uptake the funds – to ensure balanced and sustainable development of all the regions.

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