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THE SPATIAL IMPACT OF EAST-WEST INTERGRATION IN EUROPE

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George Petrakos

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DEPARTMENT OF PLANNING AND REGIONAL DEVELOPMENT

THE SPATIAL IMPACT OF EAST-WEST INTEGRATION IN EUROPE

George Petrakos[1]

Introduction

The European economy has changed in very important ways during the last decade, either due to market forces and dynamics or institutional change and policy making. In addition, Europe itself has changed, as the old divides both actual and perceptual are in the process of being altered and replaced by new ones. The driving forces of change are two fundamental, parallel and interacting processes: the one is related to the operation of the Single European Market (SEM) and the European Union (EU) policies towards the Economic and Monetary Union (EMU), and the other is related to the economic transformation and the westward orientation of the Central and Eastern European (CEE) countries. Both processes have been associated with strong expectations for growth and prosperity, both currently face difficulties of varying types and degrees and both have a strong spatial dimension.

Our goal here is to analyse the spatial implications of the on-going interaction of integration and transition processes and focus on the key characteristics and spatial dynamics of the emerging pan-European geography of the 21st century. A number of important features of the emerging European geography with long term implications for policy making in the next century have to be analysed and understood in depth. Issues such as the north-south and east-west divides, patterns of convergence or divergence, the spatial allocation of costs and benefits of the integration-transition process, factor movements, regional trade patterns, regional co-operation and cross-border dynamics of the new Europe need to be discussed in connection with the new realities imposed by the removal of the artificial barriers to interaction in the post-1989 European economic space.

The Forces at Work

(a) The Policies and the social Dynamics

Several forces have been shaping the new European economic space, including the policies of integration and transition, the social dynamics and the market forces. The policies of EU integration are basically the policies of the Single European Market [SEM] and the policies towards the Economic and Monetary Union [EMU]. They are mostly market oriented policies aiming to increase the efficiency and competitiveness of the fragmented European economy in the face of increasing internationalisation of economic interaction. These policies raise an "efficiency versus equity" conflict at various social and geographical levels, as the process of integration is associated with winners and losers. For this reason they are supported by structural operations (Structural and Cohesion Funds), aiming to offset the negative impact of the forces released and assist less developed and structurally weak regions

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[1] Department of Planning and Regional Development, University of Thessaly, 383 34 Volos, Greece.

e-mail: petrakos@uth.gr

On the other hand, the unsustainable pre-1989 economic and political structures and a profound case of government failure in the former planned economies have imposed the policies of Transition. They are also market oriented policies (privatisation, liberalisation, internationalisation) and policies of institutional change. Up to this point and several years after implementation, great variations in results have been recorded, as destructive adjustment processes have persisted in several sectors and a number of countries.

Finally, the policies of EU Enlargement depict the political will of the West to integrate with the East and have been expressed through the assistance provided by the Phare Program, the Association agreements and the Agenda 2000, where 45m ECU in Structural Funds are proposed to be allocated to the new members in the 2000-2006 period.

Significant social dynamics have also been behind the East-West interaction affecting its type, direction and pace. On the one hand, there is a strong drive in the East for Western-type political organisation, institutions and lifestyle but also resistance to change due to enormous adjustment costs and increasing social fragmentation. On the other hand, there is a strong drive in the West backed by multinational corporations and large business for an eastwards market expansion, but also an uneasiness in labour, related to migration and the mounting problem of unemployment.

(b) The Market Forces

Market forces are also playing a significant role in determining the characteristics of the new European economic space. First, the process of transition has expanded the European market by 49% in terms of population, but only by 5.2% in terms of GDP (Table 1). The first figure indicates the long-term potential of the new market, while the second indicates the medium-term difficulties and the present limits of East-West interaction. It should be noticed however, that with expansion, first to the South and now to the East, the EU is being transformed from a homogeneous club to a heterogeneous Union, as these expansions involve States with lower than average development levels.

The most significant market force that affects the European economy is the East-West trade relation. East-West trade relations have experienced a rapid but unbalanced expansion of a basically inter-industry type. In the 1992-1997 period, EU exports to CEEC increased by 210%, EU imports from CEEC increased by 121% and EU trade surplus with the CEEC increased by 904% (Table 2). Italy, Germany and Austria have enjoyed the greatest trade surpluses, indicating that proximity to the East-West frontier is an important factor determining performance in the new markets. Despite rapid growth, however, East-West trade is still a small fraction of EU trade, as only a small share of EU exports (4.4%) go to CEEC and only a small share of EU imports (3.3%) comes from CEEC. The greatest part of EU trade (67% of exports and imports) is still intra-Community trade. These figures indicate that East-West trade is presently restricted by the capacity of CEEC markets.

Several studies (Landesmann 1995, 1998, Petrakos 1996, Petrakos 1997a, Petrakos and Totev 1999) also indicate that East-West trade relations, just like North-South relations, have a predominantly inter-industry character. Western Europe tends to specialise in R&D-intensive, capital-intensive and knowledge-intensive products, while Central and Eastern Europe tends to specialise in labour-intensive and resource-intensive products.

In addition, the new economic environment in Europe is obviously characterised by more intensive factor movements with a clear spatial dimension. Flows of labour and capital, despite various sorts of barriers, cross the East-West borders following the predictions of a simple neo-classical two-

sector model where price and opportunities differentials result in eastward capital flows and westward labour movements.

EU Foreign Direct Investment to CEEC has increased significantly (Table 3), but to levels that are in general below expectations. Total invested capital in most cases is less than 1% of recipient countries' GDP and the real impact to most CEE countries is limited. Hungary, The Czech Republic and Poland are the most frequently selected destinations, while Germany (by far the first), The Netherlands, France and Italy are the origin of most significant investors.

Turning to migration flows, we observe that despite an enormous stock of potential migrants in CEEC, East-West migration is limited due to EU policies and is to a large extent illegal. The countries that receive the greatest numbers of migrants are Germany, where 8% of the population is already foreign (Faist and Haubermann 1996) and Greece, where illegal immigration from Albania and Eastern Europe is estimated at 500 thousand people (Petrakos 1996). Migration to the West has in several cases shifted mood in the receiving areas and countries against immigrants. Even a relatively small number of immigrants from Albania to Italy (40.000) has been enough to reverse attitudes (Zinn 1996). In general, newcomers are conceived as a threat to labour markets, social benefits and cultural homogeneity. Xenophobia seems to be a long-term threat that can affect ideology in the "democratic west". Whether or not this threat will materialise, xenophobia has certainly affected the East. Liberalisation in CEEC product and capital markets combined with protection in EU labour markets, generates unequally distributed costs and benefits as market adjustments under this mix of liberalisation and protection clearly work in favour of the West.

The Spatial Characteristics of EU integration

Although a positive sum game, EU integration leaves winners and losers (CEC 1991, CEC 1992b, CEC 1993a, Camagni 1992, Amin et. al. 1992, Peschel 1992) by exposing regions with unequal endowments in resources and technology and different economic structures to international competition (SEM). In general, peripheral regions with weak economic structures and deficient infrastructure and human resources have fared worse in the integration process.

One of the reasons is that, sectoral specialisation and North-South trade in the EU still maintains an inter-industry character. The core regions specialise and export to the periphery high-tech manufacturing and producer services, while the periphery exports to the core regions low-tech manufacturing and extracting activity products. As a result, trickle-down effects assumed to stem (according to the Maastricht convergence criteria) from the core regions to the peripheral ones will be limited (Mack and Jacobson 1996).

On the other hand, the SEM has resulted in an increase in the market penetration of regions lagging behind, increasing trade deficits and increasing the erosion of their productive base. Greece and Portugal, the two weakest members of the EU, have the greatest trade deficits as a share of GDP in the EU (-12,9% and -10,4% respectively in 1995). In addition, the trade deficit of Greece with the rest of the EU increased in the period 1989-1995 by 218%, while the share of manufacturing output shrank to 16% in 1995 (the average EU figure is 23%). As a result, redistribution at the expense of the less favored regions takes place at the EU level, through the mechanisms of the Single Market.

Under the pressure of market forces EU regional policy (Structural and Cohesion funds) has been designed to compensate for the effects of increasing competition, by providing less favored regions with the means to improve social and technical infrastructure, education and the competitiveness of industry. Two points deserve attention here. First, although available funds increased significantly

between the 1st (1989-1993) and the 2nd (1994-1999) CSF, they are proposed to stagnate for the 2000-2006 period. Given the strong North-South type of regional disparities in infrastructure that still exist in the EU (Martin and Steinen 1997), these funds are clearly below the levels required to have a substantial impact in a reasonable time horizon.

Second, the funds do not have the necessary spatial focus, as a very large share of EU population (over 45%), is eligible for EU *and* National regional support. In several cases, advanced EU countries provide State aid per capita in the form of incentives to enterprises that is higher than in poor countries, partly due to the severe budgetary constraints faced by the latter. As a result, National programs seem to largely offset the impact of EU regional policies at the enterprise level, intensifying the locational disadvantages of the peripheral States and regions (Martin and Steinen 1997). Moreover, first reports show that the funds had the least impact in the regions that needed them the most (Economou 1997), raising a question about the implementation of the Programs, but also a question of low regional multiplier impact.

The spatial characteristics of Transition.

The systemic changes that have taken place in the former socialist countries possess a major challenge for regional economic analysis and regional development policy. This unique situation, where central control mechanisms are abandoned giving their place to market mechanisms and at the same time domestic productive bases are opened and exposed to international economic forces, raises a number of important questions about the regional characteristics of the transition process and the future organisation of economic activity over space. A number of studies have already appeared discussing the distribution of the costs and benefits of restructuring over space and the impact of the operation of economic forces across regional productive bases (Gorzelak 1996, Jackson and Petrakos 1996).

(a) The impact of Internationalisation

For CEE countries, the openness and westward orientation that followed the 1989 reforms have led, in most cases, to a rapid internationalisation of the economy, its main characteristics being the influx of foreign direct investment and the fast increasing, although unbalanced, volume of trade. Despite a number of temporary constraints associated with political and legal uncertainty and institutional weaknesses that discourage large immediate expansion (Peschel 1992, CEC 1993b), foreign investment is expected to be a determinant of gross capital formation in these countries with significant spatial implications.

It becomes increasingly evident that the behaviour of foreign capital with respect to location is highly selective (CEC 1993a), contributing, at least in the early stages of the transformation process, to a polarised pattern of development. In a more integrated economic environment where barriers to international transactions and factor movements are reduced, global pressures require international investors and multinational corporations (MNCs) to select new business locations with a strategic character. As a result the economic, geographical, functional and demographic characteristics of regions at the national and international-European level become very important. Central places with respect to the European economic space will attract a larger number of activities with a higher functional order, while non-central places will receive a smaller number of lower order activities (Cohen 1981, Petrakos and Brada 1989, CEC 1992b, CEC 1993a, Rosenbald and Pumain 1993).

It seems therefore that a first spatial impact of the openness and westward orientation of the ECE countries will be a disproportionate concentration of foreign capital in the metropolitan area and a polarising pattern of economic growth. The lower the level of development of the host country, the higher the rate of foreign capital concentration (due to inadequate infrastructure and market conditions in smaller cities) and the greater the polarisation effect is expected to be. Because of the adaptive nature of the foreign capital expansion-path, where imperfect information and economies of clustering require that new investment is located near to existing ones, this process of concentration will continue until land availability in the metropolis becomes an inescapable problem. As a result the process of internationalisation has favoured a polarised economic structure.

Openness however and economic integration with the Western European economy has an additional spatial implication that depends on the adjacent position and the proximity of an ECE country to Western Europe. For ECE countries having common borders with West Europe there are significant opportunities for trans-frontier co-operation in the form of joint ventures, subcontracting, free trade areas, scientific and technological co-operation, local or regional policy co-ordination as well as expansion of cross-border transportation and communication infrastructure. Therefore common borders are expected to generate local economic activity and create an alternative route for foreign capital penetration. This may imply a diversion effect for foreign capital as a part of it originating from neighbouring countries prefers the benefits of proximity to the benefits of the metropolitan market. It seems therefore that internationalisation and openness have two distinct spatial effects that operate in favour of the metropolitan areas and the western regions, intensifying polarisation and a geographically divided pattern of development.

Besides capital flows, the resumption of international trade with Western European countries and the collapse of the CMEA relations with the other Eastern European countries and the former Soviet Union will be an important factor with serious regional implications. Reduction or elimination of existing trade barriers with the West increases imports and exposes previously protected regional production bases to international competition. As a result, regions that were heavily dependent on CMEA relations or military contracts, monostructure regions or regions with a weakly integrated production structure, are expected to be more sensitive and suffer directly from the openness of the economy. On the other hand, regions with a diversified production base and regions that have implemented a successful land reform and reorganisation of agricultural production may have greater success in adapting to the new international environment.

Finally, openness and integration into the European economy has an additional macro-geographical impact that is related to the proximity of each country to the western European development centres. Distant countries will be integrated more slowly and selectively while adjacent ones will experience sooner the benefits of an eastward directed dispersion of development. Because of the gradual elimination of barriers and the creation of a large European market, geographical factors such as distance, accessibility and centrality emerge as important elements of the spatial organisation of activities and the slowly shaped new spatial European economic order (Peschel 1992, Rosenbald and Pumain 1993). In general, it can be argued that the closer to the European gravity centre an ECE country is, the greater the possibility is of attracting higher order economic functions and developing multiple strategic location cities or regions that will be placed in the upper part of the European hierarchy. In other words, as distance from the European centre of gravity increases, so does the number of cities and regions that do not qualify as European-level strategic locations.

Overall, the impact of internationalisation and integration on the spatial regularities of the ECE countries is exerted through a complex set of interacting processes and cannot be attributed to a single overriding factor. The influence however of international forces operating through the selective behavior of foreign capital and the unbalanced pattern of international trade along with the

emerging importance of geographical features are expected to have a strong spatially dividing character. Metropolitan areas, western regions, regions with a diversified production base and those located a short distance from the European development centre are expected to experience a positive net effect from internationalisation. On the other hand declining monostructure, eastern and perimetric regions are more likely to experience an unfavourable net impact from openness that will further intensify their problems and make the task of restructuring even harder. These regions will tend to replace Southern Europe in forming the new European periphery of the next century.

(b) The impact of Restructuring

The process of transformation is also expected to have a spatial dimension that is attributed to the operation of more "endogenous" factors such as the pace and success of the restructuring policies, the existing condition and quality of the labour force and infrastructure and the changes in the sectoral composition of output.

In the first place, it is expected that there is an inverse relation between restructuring and growth on the one hand and regional disparities on the other. The faster the pace of restructuring and growth, the more likely it is that regional disparities will be diminished. This will occur because of anticipated spread effects and because growth provides the State with the financial resources to intervene and implement an active regional policy. In contrast, a prolonged recession and crisis will have devastating effects on the regions with the weaker and more vulnerable production structures. The experience of the EU, that went from a period of high growth and declining regional disparities that ended in the mid 1970s, to a period of low growth and increasing regional disparities afterwards, (CEC 1991, Dunford and Perrons 1993) is very indicative of this inverse relationship. However recent findings tend to cast some doubt on this argument. Petrakos (1998) has found evidence indicating that disparities in transition economies are higher or increase more systematically in countries with a better performance in terms of GDP growth in the 1990-95 period. This is in line with evidence coming from Southeastern EU States (Petrakos and Saratsis 1997), but it is in variance with findings concerning the more advanced EU members and the EU as a whole. As a result, it is likely that in countries with lower level of development (as those in Central and Southeastern Europe), growth and a successful implementation of economic policies at the national level seem to be positively related with higher disparities.

In addition to this, another relationship well established in the literature indicates that beyond some level of development and with stable and favourable socio-political conditions, higher levels of development are associated with lower levels of regional disparities (Williamson 1965, El-Shakhs 1972, Weaton and Shishido 1981, Petrakos and Brada 1989). This inverse relationship is believed to occur either because agglomeration economies tend to be exhausted beyond some concentration level of economic activities, or because of the political awareness of the peripheral regions and the implementation of serious regional policies. In general and in the case of the ECE countries it can be claimed that high rates of growth and high levels of development are more likely to lead to regional convergence, while low rates of growth and low levels of development are more likely to lead to regional divergence.

Metropolitan areas and industrial regions will also benefit from a sectoral shift in the composition of output that has taken place in the modern post-industrial world and is slowly being transmitted into the ECE economies. This shift is related to the growing importance of the tertiary sector and the benefits of agglomeration and scale that it derives from its operation in metropolitan areas and large urban concentrations. Activities with an increasing importance in today's economies, such as high-

level producer services, banking, financial services, entertainment and commerce, have a strong urban character and can be important sources of employment creation and growth in large urban concentrations (Coffey and Polese 1987, CEC 1992b, Fournier and Axelson 1993, Lever 1993). As a result, central and peripheral regions will not equally share the benefits of this sectoral shift that is expected to follow the process of restructuring.

(c) The empirical evidence

There is now mounting evidence that Transition has increased disparities, as western regions and metropolitan areas in general fare better (Downes 1996, Petrakos 1998)). For example, core-periphery differences have increased in Estonia, with Talin benefiting the most from the new orientation of the country. Also Western coastal regions are faced with new opportunities in trade, tourism and joint ventures, while Eastern regions face mounting problems in their primarily agricultural economy as traditional ties with large Russian markets in St. Petersburg and Pskov have been interrupted. Talin has the greater concentration of foreign capital and joint ventures, the greatest number of new enterprises and the higher income per capita in recent estimates (Raagmaa 1996). Evidence from East Germany already indicates that development is highly selective and depends on the behavior of foreign capital. Berlin emerges as a development pole with strong links with the West German and international economy but weak local linkages and low spread effects (Haussermann 1993).

Similar trends are detected in The Slovak Republic, where Bratislava with 9% of national population, generates 30% of the country's GDP (Balaz 1996), while in Hungary, where disparities have increased during transition (Fazekas 1996, Nemes-Nagy 1999)), FDI and domestic capital prefer metropolitan and western regions (Lorentzen 1996), turning the relatively balanced pre-1989 situation of the regions into an east-west disparity.

Similar evidence also comes from Poland, where FDI go to metropolitan regions and business services and financial activities develop faster in metropolitan areas and western regions (Kratke 1996). In 1994 the metropolitan region of Warsaw, Krakov, Poznan and Katowice had the lowest unemployment rate. Also, the regional pattern of unemployment in Poland shows some considerable stability in the 1990-1994 period, indicating that initial best performing regions are the same as final best performing regions and initial losers are final losers also (Ingham et.al. 1996). The picture is completed with reports from Albania (Petrakos 1996), Bulgaria (Minassian and Totev 1996, Petrakos 1996) and Romania (Ramboll 1996, Constantin 1997) that indicate that economic activities are polarised and that disparities have increased during transition.

The Macro-Geographical Impact of East-West Interaction

(a) Towards a New Spatial European Order

Another source of influence that is exerted on the performance of the regions in ECE countries comes from the relative position of each country within the slowly shaping new European economic space. Given that in the EU a large part of regional disparities is attributed to inter-country rather than to intra-country disparities, it becomes clear that the relative standing of each country, on the macro-geographical level, affects the internal micro-geographical allocation of activities. Regions can undertake a strategic or central function that is not derived only from their relative position within their country, but also from the position of the country within the emerging hierarchy of the European economic space. In other words, peripheral regions in countries placed high in the

European hierarchy will not have the same difficulties and will not move along the same trajectories as peripheral regions in perimetric countries.

Regardless of the impact of the macro-geographical regularities on the performance of regions, the study of the new European economic space, its hierarchy and structure, has an interest of its own because of the expected impact of the transformation and openness of the CEE countries.

Petrakos(1996a) has outlined the shape of the new European economic hierarchy as well as the expected dynamic benefits that will accrue to ECE countries from their geographical position and their relative size within the new European economic space, by constructing a simple European level gravity index (Z_i), estimated in three different time horizons:

$$Z_i = \sum_{j=1}^{N-1} (P_i * P_j / d_{ij}^{k})$$

where Zi is the Population Potential of a country i, Pi is the population of this country, Pj is the population of any other European country, dij is the aeroplane flight distance between the Capitals of the i and j countries and k is an exponent that takes the values k=1 or k=1.2, differentiating distance from accessibility where barriers other than geographical are present. Depending on the time horizon, N takes the value N=18 (Western European countries only) or N=33 (Western Europe plus CEE countries). The usefulness of this index relies on the fact that it consists of a composite measure of the market size of a country (approximated by population) and relative accessibility of the centre of this market to the other European markets. As such, the index depicts the relative importance and strategic advantage that a country offers, as a location site, to its economic activities and especially those operating in international markets.

Therefore, this economic and geographical index can be taken to indicate the level of economic interaction as well as the relative attraction that a country exerts on high order economic activities. This attraction is generated by (a) its own market size and (b) its strategic position with respect to the entire European market. As a result a spatial order of the European economy is shaped because of the importance of national market sizes and costs related to distance. High values of Zi imply that a country maintains a size or locational advantage highly valued by European-level economic activities.

This index, we believe, is also useful for any effort that intends to trace the spatial dynamics generated by the process of integration in Europe. Maps 1, 2, and 3 show the spatial order of population or economic potential (Zi) in three historic phases. The first one depicts the spatial order of economic potential in the pre-1989 Western Europe (k=1, N=18). The second map takes a short-to-medium term perspective of the openness and integration of the ECE countries into the European economy and accounts for the difficulties of the transition period by setting k=1.2 when either i or j is an ECE country (k=1 or k=1.2 and N=33). Here, although transformation is understood as a distance (in the broad sense of the word) reducing process, well known existing difficulties do not allow us for the time being to treat distance from Paris, for example, to Warsaw in the same way as distance from Paris to Rome, since accessibility is not, in the short-term, the same. Finally the third Map takes a long-term perspective and depicts the spatial order of economic potential of countries in a unified and obstacle-free European economic space (k=1 for every i,j and N=33). Each map also gives a bottom-up ranking and the relative value of the economic potential index for each country.

From observation and comparison of the maps a number of important observations about the spatial character of integration can be made. First, it is important to observe that in the pre-1989 European spatial order the gravity centre coincides with the economic development centre. In Map 1 we see that Germany takes the highest value of the population potential index (given in relative terms), followed by France and the United Kingdom. Correlation coefficients between the population potential index (Zi) on the one hand and GDP, industrial product and total exports on the other, give values of 96, 93 and 95 per cent respectively, indicating that this simple geographical index of distance and size explains a very considerable part of the level of development and the degree of integration between European countries. We also see that the index has a hierarchical structure. Its figure for example for Denmark is less than 8 per cent of the German figure and this difference is mainly attributed to the impact of different country (or market) sizes. Serious differences however exist even for countries of similar size. The figure for Greece for example is less than 1/3 of the Belgian figure although both countries have the same population. Clearly this difference arises from the more favourable geographical site of Belgium with respect to the other European countries, which implies better accessibility to the European market and a more strategic location (Petrakos 1996a).

Second, by comparing the Zi values in Maps 1, 2 and 3 and Diagram 1, we see that the greater relative improvements in economic potential are expected to be for Germany (explained by the increase in its size due to unification and by its central location), and for the countries with the closest proximity to the new economic space, that is Austria, Greece, Sweden and to a lesser extent Denmark. Most other countries will see their position more or less deteriorating in relative terms (although improving in absolute terms). This suggests a relative shift of the gravity centre to the east giving advantages first of all to Germany which is becoming the centre of the European space instead of being its eastern border. Besides that, the shift also gives advantages to Austria, Greece and Sweden, that in relative terms outweigh the increase in Germany's size. The largest reductions in the relative value of the Zi index are recorded in the U.K., France and Spain that are located away from the expansion of the economic space, and have distance-related constraints that do not allow them to take full advantage of it.

Third, in the long run but also to a lesser degree in the short-term, the integration of the ECE countries will displace many small and perimetric countries in the spatial European economic order. Portugal, for example, from 10th place in the pre-1989 spatial order moves down to 18th place displaced in the Long-term by 6 ECE countries. The same can be said for Ireland which moves from 15th to 25th place surpassed by 9 ECE countries. On the other hand, the large European countries (Germany, France, U.K., Italy) maintain in all phases their top-four positions, although Spain is displaced in the long-term from 5th to 6th place by Poland, and Austria and Switzerland are displaced from their pre-1989 top-10 position by Romania and the Czech Republic. It is interesting here to see that, for some Western European countries, the order in which they are placed with respect to each other in the long-term index, has been inverted. Austria is placed ahead of Switzerland, Greece and Sweden ahead of Portugal, and Norway and Finland ahead of Ireland in the long-term although the opposite was the case in the pre-1989 hierarchy. This of course indicates the relative improvement of the position of the countries that are closer to the new economic space in the East (Petrakos 1996a).

Fourth, wide variations are also found in the long-term potential of ECE countries. The one that has benefited most from the process of integration is Poland which has a population potential index half of the German figure and is placed 5th in the pan-European hierarchy. A very good ranking is also attained by Romania and the Czech Republic (8th and 9th place) that are followed by Hungary (11th place), while New Yugoslavia and Bulgaria have an economic potential that places them in the upper half of the long-term hierarchy. The rest of the ECE countries have a very small

population potential index, being placed at the lower part of the hierarchy. The long term standing of these countries in the pan-European spatial order may also be interpreted as an indicator of the success of their economic integration with Western Europe. High values of the population potential index imply a strategic location or size that in the long term will result in serious interaction and strong economic links with the western centres of development. On the other hand, a low value on the gravity index implies either a small market size or a really perimetric location.

Fifth, the process of integration has a potentially diverging character as it increases disparities with respect to the attractiveness of national central places in a pan-European economic space. We observe in Maps 1, 2 and 3 that the coefficient of variation (σ/x) of the Zi index increases from 1.15 in the pre-1989 period to 1.52 in the short to medium-term scenario to drop only in the long-term scenario to 1.34, which, however, is still higher than the initial value of the coefficient. Therefore disparities attributed to geographical considerations such as centrality or accessibility and national market size, will experience a substantial increase during the transition period. This indicates that perimetric ECE countries will, in principle, be in a more unfavourable situation in the new European space than perimetric Western European countries were in the pre-1989 Europe. Although in the long-term scenario the situation improves considerably, the degree of disparities remains still higher. It is worth-noting here that, although these trends are expected to influence the prospects of CEE countries for future growth and development, they materialise independently from current economic conditions and existing difficulties in these countries. This, of course, indicates that the tasks of economic convergence and social cohesion will be much harder to achieve in the new Europe than it was in the pre-1989 period (Petrakos 1996a).

Similar findings have been found in another paper examining the spatial implications of East-West trade with an entirely different methodology (Brocker and Jager-Roschko 1996). According to this, the regional implications of transition seem to be favourable not only for adjacent EU countries, but also for EU regions lagging behind. Mainly due to favourable locational effects, average gains from trade with CEE countries are greater for Greece and Southern Italy. Gains of the lagging regions at the western rim of the EU are almost the same as those in non-lagging regions. As a result, trade threats to the regions lagging behind in the EU seem to arise much more from the more prosperous regions of the EU, Japan and the NICs, than from transition economies. Fears that Objective One regions in the EU and Transition countries will have antagonistic structures do not seem valid.

Closing the discussion on the new spatial European economic order, we should admit that this issue has an important dimension concerning the impact on the cities that has not been addressed here. However, in this new environment, the European urban hierarchy is also expected to change. Although central functions at the highest level remain concentrated in a few world or European level cities, competition will be more intensive in lower rank cities housing or seeking functions with a more mobile character. In this new environment, the European cities will increase in various degrees their economic heterogeneity and social segregation. Mostly illegal immigration in the West is expected to increase the dual character of the urban markets and the size of the informal sector, while Multinationals in the east are expected to support or generate an economic and social urban elite with living standards much higher than the average.

(b) Integration and Disintegration in Europe

Available recent evidence indicates that EU integration and CEEC transition processes face serious problems and difficulties that seem to have a clear geographical dimension. On the one hand, integration generates severe pressure for adjustment to the less advanced Southern European

countries that have recently internationalised their economies with, in most cases, unsolved problems of efficient organisation of their productive bases and on the other, the experience of transition shows that all countries did not adjust or perform in the same way. There is now sufficient evidence that in terms of economic structure and performance, a north-south divide is present in both EU and CEE countries (Petrakos and Totev 1999, Petrakos 1997a, Mertzanis and Petrakos 1998).

Within the EU, North and Western European countries have a better performance and a more sustainable economic structure than Southern European ones. Within CEEC, the Visegrad countries have a better performance and a better economic structure than the Balkan ones. Although not explicitly stated, it is beyond any doubt that in this cosmogony of changes that is shaping the new Europe, the worst performing place in all accounts is the Balkan region. With existing trends, the new economic divide in Europe may take a Northwest-Southeast character, where the Southwest and the Northeast will take the intermediate positions.

With respect to convergence and divergence trends in the new European space, it is obvious that the process of transition has increased disparities with respect to development levels in Europe, as variations in GDP per capita in a pan-European scale were greater in 1995 than in 1987 (Petrakos and Christodoulakis 1998). The more obvious divergence trends with respect to GDP per capita figures take place in the Balkan region. If present trends continue, for many countries especially in the East, it will take several decades for a real convergence to the average EU GDP per capita level.

Policy Questions

Available evidence indicates that the process of East-West integration in Europe is associated with increasing spatial disparities at all levels, suggesting that, under existing policy trends, our common European future will be a multiply divided one. A market based North-South, East-West integration will lead to a permanent divide in economic structures and levels of development, while a 'business as usual' policy scenario that sticks the EU budget to the 1.27% of GDP spending limit, will be totally inadequate to deal with the realities in the East and in several cases in the South.

The discussion however of EU fiscal policy requires a firm understanding that the policy response problem for the East and the South, is in fact a problem of redistribution of the costs and benefits of economic integration. A simple examination of the trade balances of each EU country will give us an idea of who the winners and the losers are. It will show how inadequate the sums provided for structural funds are compared to income redistribution through market penetration. For example, the accumulated trade deficit of Greece with the other EU countries in the 1989-1994 period is 9 trillion USD, a figure that is almost 3 times higher than the 1st CSF of Greece.

However, these issues are not usually addressed, as there is an inherent bias in policy making and in policy evaluation that excludes more interventionist approaches from the policy options. The dominant economic paradigm (advocating deregulation, privatization, market liberalization, market-friendly policies, minimum public intervention, market self-regulation). is rarely compared or contrasted with the more interventionist approach of Japan or China. In economic thinking and policy making, market self-regulation has received an axiomatic status, despite the poor record of market oriented policies in the Third and most of the Second World (Taylor 1996).

Although government failures (of a specific systemic choice) have been profound in the former Socialist block, market failures seem to be equally devastating in several parts of the Second and the Third World. A new synthesis of economic regulation is needed, that will take into consideration (a)

the dynamics of the markets, (b) the structural realities of the economies under consideration and (c) the lessons of the 1950s and 1960s, when the post-war European economies adopted more interventionist approaches, having a task similar in magnitude to accomplish.

On economic grounds, a tight fiscal policy dictated by the Maastricht criteria is not necessary at the EU or the National level for the success of the EMU. On the contrary, a successful monetary union may require that governments that have lost their monetary and exchange rate flexibility resort to a more flexible fiscal policy. Belgium and Luxembourg have a successful monetary union and yet the biggest and smallest public deficit in the EU for years (The Economist 1997). Homogenising fiscal policy at the national level may be associated with increasing regional disparities (as some regions are expected to lose from the monetary union) and efficiency losses (as different countries face different economic structures and problems). As a result, tight fiscal policies at the national level cannot be sustainable unless an EU federal budget or a systematic EU mechanism of fiscal transfers matches them.

In cross section analysis, it has not escaped attention that as policies in transition countries become more homogeneous, output becomes more varied (Murrell 1996), suggesting, along with the discussion above, that failures have a structural dimension (Petrakos and Totev 1999). This indicates that a reorientation of policy towards not so much the successful paradigms, but the laggards and losers of the integration-transition race is necessary, as success and failure is not only a question of economic policy but primarily a question of economic structure. The only way to avoid a permanently divided economic space, is to decisively support great ideas (a common European house) with the necessary strength and policies that will compensate for locational disadvantages, inefficient economic structure, deficient infrastructure and inadequate mechanisms of advancing human capital in both the East and the South.

Along these lines should also be the discussion on policy responses at the regional level in CEE countries. Although regional policies have already been formulated in some cases, especially in the Visegrad group, regional funds as a share of GDP (0.3% in Hungary and 0.1% in the Czech Republic) are far behind the figures of the peripheral EU States (Downes 1996). Given the magnitude and the trends in regional disparities, we would add that they are also well behind the level required for a real impact. In addition, it should be clear that the bottom-up approach to regional policy is more rewarding in the prosperous west, where development largely depends on private initiatives (Lorentzen 1996). The vicious circle however, that in several instances is in motion in the east and the magnitude of forces operating at a regional scale, require co-ordinated action at the governmental and the EU level, if a real impact on regional disparities is to be recorded in a reasonable time period.

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TABLE 1. Population and GDP of EU and CEE Countries, 1994

COUNTRIES EU members	GDP millions ($) 1994	POPULATION millions 1994	Percentage over the total GDP	Percentage over the total population	Percentage over the group's GDP	Percentage over the group's population
Austria	196546	8	2,55%	1,45%	2,69%	2,16%
Belgium	227550	10,1	2,96%	1,83%	3,11%	2,72%
Denmark	146076	5,2	1,90%	0,94%	2,00%	1,40%
Finland	97961	5,1	1,27%	0,92%	1,34%	1,38%
France	1330381	57,9	17,28%	10,47%	18,19%	15,61%
Germany	2045991	81,5	26,58%	14,74%	27,98%	21,97%
Greece	77721	10,4	1,01%	1,88%	1,06%	2,80%
Ireland	52060	3,6	0,68%	0,65%	0,71%	0,97%
Italy	1024634	57,1	13,31%	10,33%	14,01%	15,39%
Luxembourg		0,4		0,07%		0,11%
Netherlands	329768	15,4	4,28%	2,79%	4,51%	4,15%
Portugal	87257	9,9	1,13%	1,79%	1,19%	2,67%
Spain	482841	39,1	6,27%	7,07%	6,60%	10,54%
Sweden	196441	8,8	2,55%	1,59%	2,69%	2,37%
UK	1017306	58,4	13,22%	10,56%	13,91%	15,75%
SEMI-TOTAL	**7312533**	**370,9**	**95,00%**	**67,09%**	**100,00%**	**100,00%**
Transition countries						
Albania	1808	3,2	0,02%	0,58%	0,47%	1,76%
Belarus	20287	10,4	0,26%	1,88%	5,27%	5,72%
Bosnia-Herzegovina*						
Bulgaria	10199	8,4	0,13%	1,52%	2,65%	4,62%
Croatia	14017	4,8	0,18%	0,87%	3,64%	2,64%
Czech Rep	36024	10,3	0,47%	1,86%	9,36%	5,66%
Estonia	4578	1,5	0,06%	0,27%	1,19%	0,82%
FYROM	1678	2,1	0,02%	0,38%	0,44%	1,15%
Hungary	41374	10,3	0,54%	1,86%	10,74%	5,66%
Latvia	5817	2,5	0,08%	0,45%	1,51%	1,37%
Lithuania	5224	3,7	0,07%	0,67%	1,36%	2,03%
Moldova	3672	4,3	0,05%	0,78%	0,95%	2,36%
Poland	92580	38,5	1,20%	6,96%	24,04%	21,17%
Romania	30086	22,7	0,39%	4,11%	7,81%	12,48%
Slovak Rep	12370	5,3	0,16%	0,96%	3,21%	2,91%
Slovenia	14037	2	0,18%	0,36%	3,65%	1,10%
Ukraine	91307	51,9	1,19%	9,39%	23,71%	28,53%
N.Yugoslavia*						
SEMI-TOTAL	**385058**	**181,9**	**5,00%**	**32,91%**	**100,00%**	**100,00%**
TOTAL	**7697591**	**552,8**	**100,00%**	**100,00%**		

Source: World Bank, World Development Report, 1996.

TABLE 2 Trade of EU with the CEE Countries (mill ECU)

	EXPORTS		IMPORTS		BALANCE OF TRADE	
EU COUNTRIES	**1992**	**1997**	**1992**	**1997**	**1992**	**1997**
BELGIUM AND LUXEMBOURG	1105	3475	884	1995	221	1480
DENMARK	732	1513	609	1127	123	386
GERMANY	14476	39016	14041	31024	435	7992
GREECE	450	751	504	1018	-54	-267
SPAIN	358	2055	502	1376	-144	679
FRANCE	2722	7108	2098	4491	624	2617
IRELAND	65	521	99	279	-34	242
ITALY	4302	14704	4180	9396	122	5308
NETHERLANDS	1768	4401	1511	2935	257	1466
AUSTRIA	2996	9434	2203	6088	793	3346
PORTUGAL	37	171	70	145	-33	26
FINLAND	646	1326	464	639	182	687
SWEDEN	866	2513	914	1257	-48	1256
UNITED KINGDOM	1642	5429	1384	3506	258	1923
TOTAL EU	**32165**	**92417**	**29463**	**65276**	**2702**	**27141**

Source: Eurostat, External Trade and Balance of Payments, 1992, IMF, Direction of Trade Statistics Yearbook, 1998

TABLE 3A Distribution of European Union's outward FDI flows to CEE Countries 1992, 1993 (mill. ECU)

1992-1993	Balkan countries	Central European and Baltic countries	Total
Belgium and Lux.	19	237	256
Germany	72	1882	1954
Denmark	6	51	57
Spain	0	8	8
Finland	0	46	46
France	11	434	445
UK	0	85	85
Italy	-9	388	379
Netherlands	0	684	684
Portugal	0	2	2
Sweden	0	85	85
Total	99	3902	4001

Source: Eurostat, FDI Statistics 1993

Table 3B. Distribution of Inwards Cumulative FDI flows in Central and Eastern Europe 1990-1997

Country	Cumulative FDI flows (1990-1997)		Cumulative FDI flows per capita (1990-1997)
	(in million USD)	(%)	(in USD)
Balkans	**7315**	**13,50**	**133**
Albania	311	0,57	91
Bulgaria	1491	2,75	179
Croatia	1167	2,15	259
Romania	3329	6,14	148
F.R. Yugoslavia	875	1,61	83
FYR Macedonia	141	0,26	71
Central Europe	**46869**	**86,49**	**705**
Slovenia	2183	4,02	1097
Slovakia	1740	3,21	325
Hungary	15508	28,62	1527
Czech Republic	8033	14,82	779
Poland	19405	35,81	502
TOTAL CEE	**54184**	**100**	**450**

Source: EIU Country forecast, 2nd Quarter 1998.

TABLE 4. The Spatial Order of Economic Potential in the Pre-1989 and the New Europe (Short-term and long-term scenario)

Country	Pre-1989	Country	Short term	Country	long term
Iceland	1,32	Iceland	1,46	Iceland	1,43
Luxembourg	6,54	Esthonia	5,46	Luxembourg	5,73
Finland	49,28	Luxembourg	6,73	Esthonia	11,55
Ireland	49,42	FYROM	6,92	FYROM	14,82
Norway	52,55	Slovenia	7,76	Slovenia	16,87
Denmark	79,79	Latvia	12,33	Latvia	25,72
Hellas	89,30	Bosnia	12,56	Albania	28,69
Sweden	94,23	Albania	13,65	Bosnia	28,96
Portugal	105,50	Lietuva	18,15	Ireland	36,35
Austria	115,84	Croatia	20,35	Lietuva	37,34
Switzerland	125,05	Slovakia	21,59	Croatia	43,39
Belgium	279,67	Ireland	41,69	Slovakia	45,68
Holland	340,97	Finland	49,34	Norway	46,08
Spain	433,61	Norway	52,44	Finland	47,47
Italy	590,31	Bulgaria	52,65	Denmark	79,16
Britain	855,04	Yugoslavia	53,08	Portugal	86,31
France	940,75	Hungary	84,40	Hellas	94,12
Germany	1000,00	Denmark	85,68	Sweden	98,07
		Hellas	96,68	Bulgaria	106,24
		Portugal	98,99	Yugoslavia	109,53
		Romania	100,88	Switzerland	112,85
		Sweden	104,49	Austria	133,23
		Czech	118,83	Hungary	162,75
		Switzerland	124,39	Belgium	193,00
		Austria	136,79	Czech	212,04
		Belgium	223,32	Romania	213,50
		Poland	255,53	Holland	245,30
		Holland	277,65	Spain	369,81
		Spain	411,50	Poland	500,93
		Italy	569,38	Italy	552,63
		Britain	821,54	Britain	738,17
		France	901,01	France	814,37
		Germany	1000,00	Germany	1000,00
min= 307936925847		min= 386978554216		min= 477937881266	
max=231741298518588		max=26360089770360		max=333925816980254	
Coefficient of variation =1,15		Coefficient of variation =1,52		Coefficient of variation =1,34	

Figure 1. Population Potential Levels in Western Europe in the pre-1989 and the Long-term Scenario

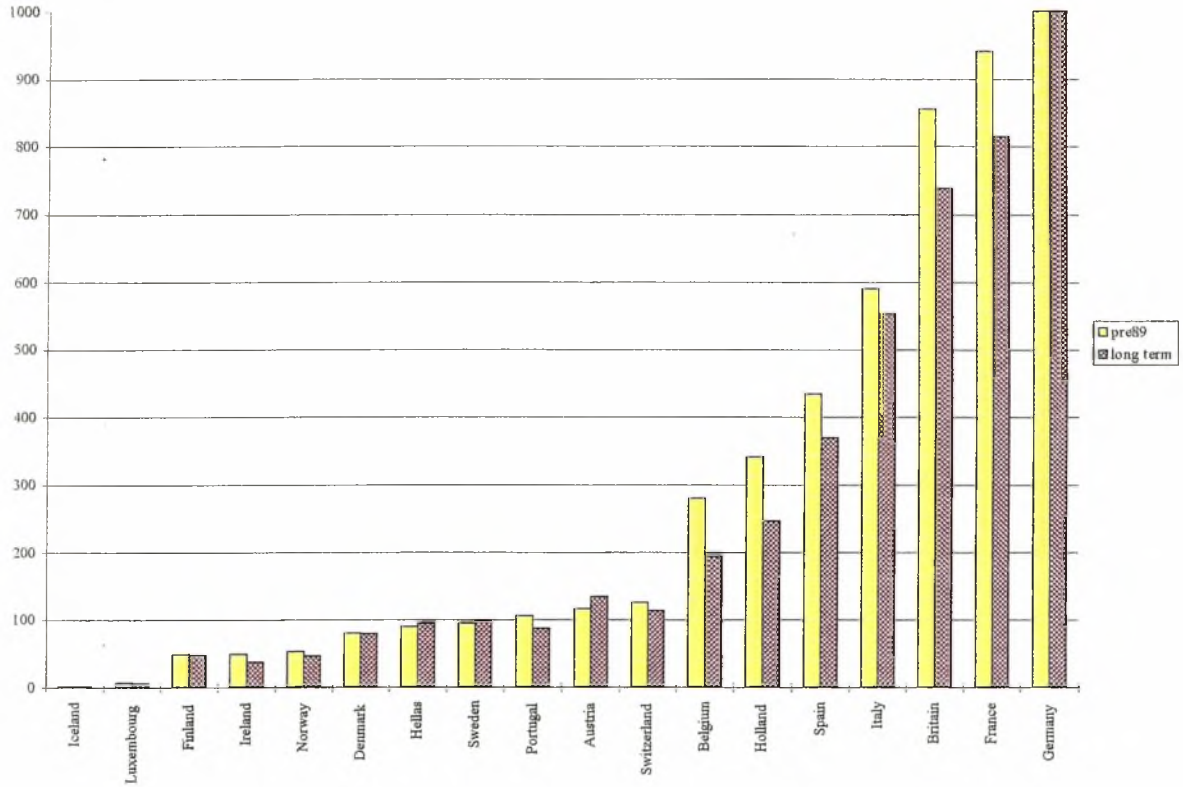
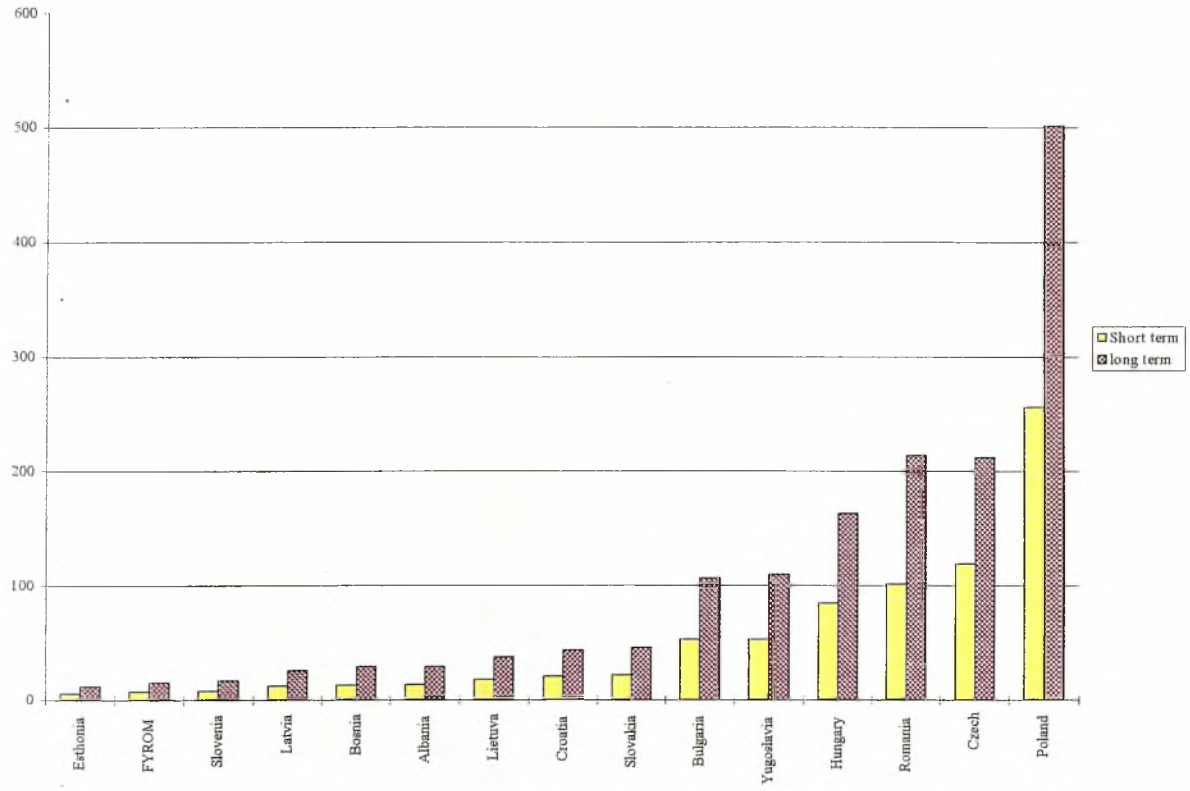
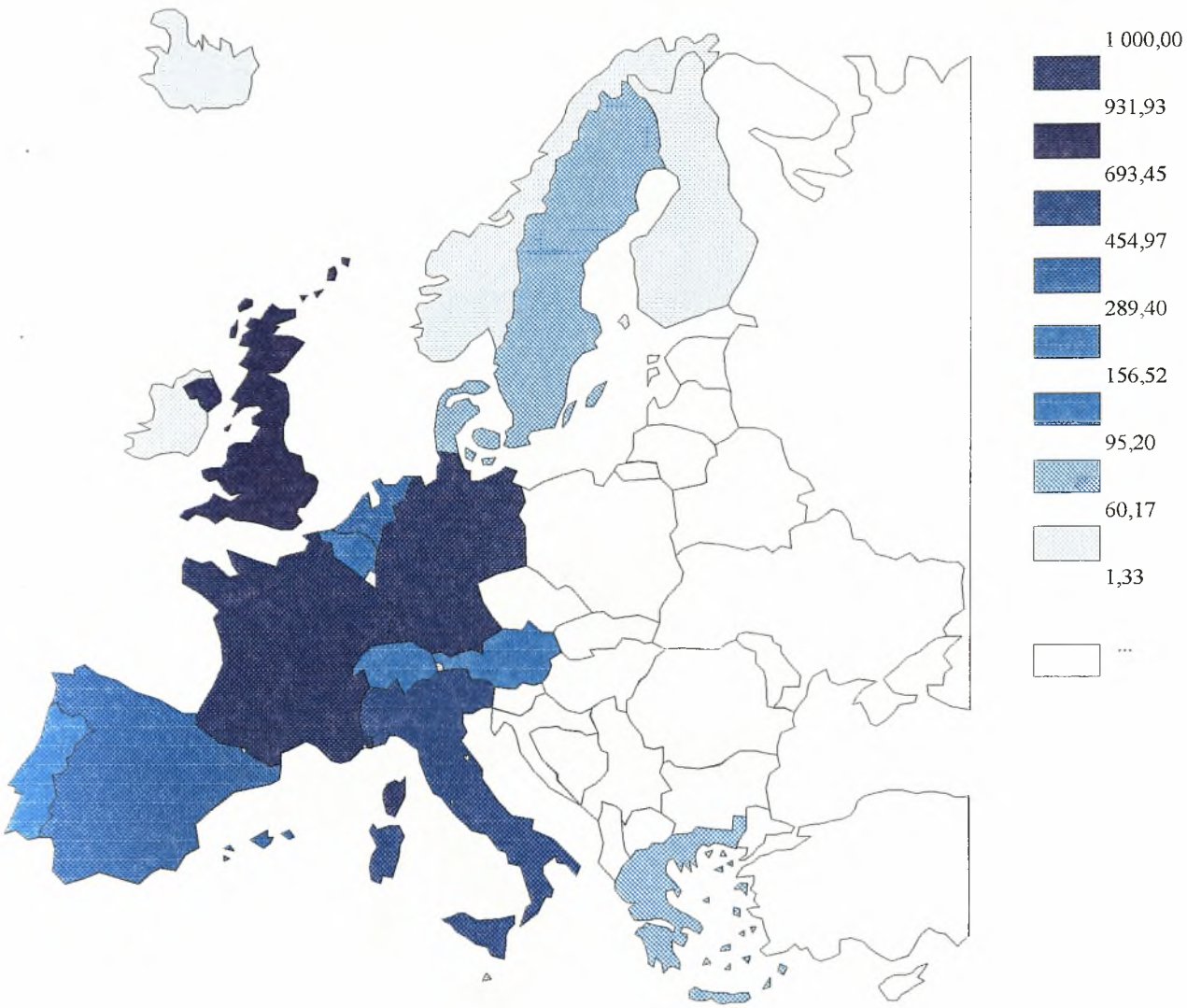


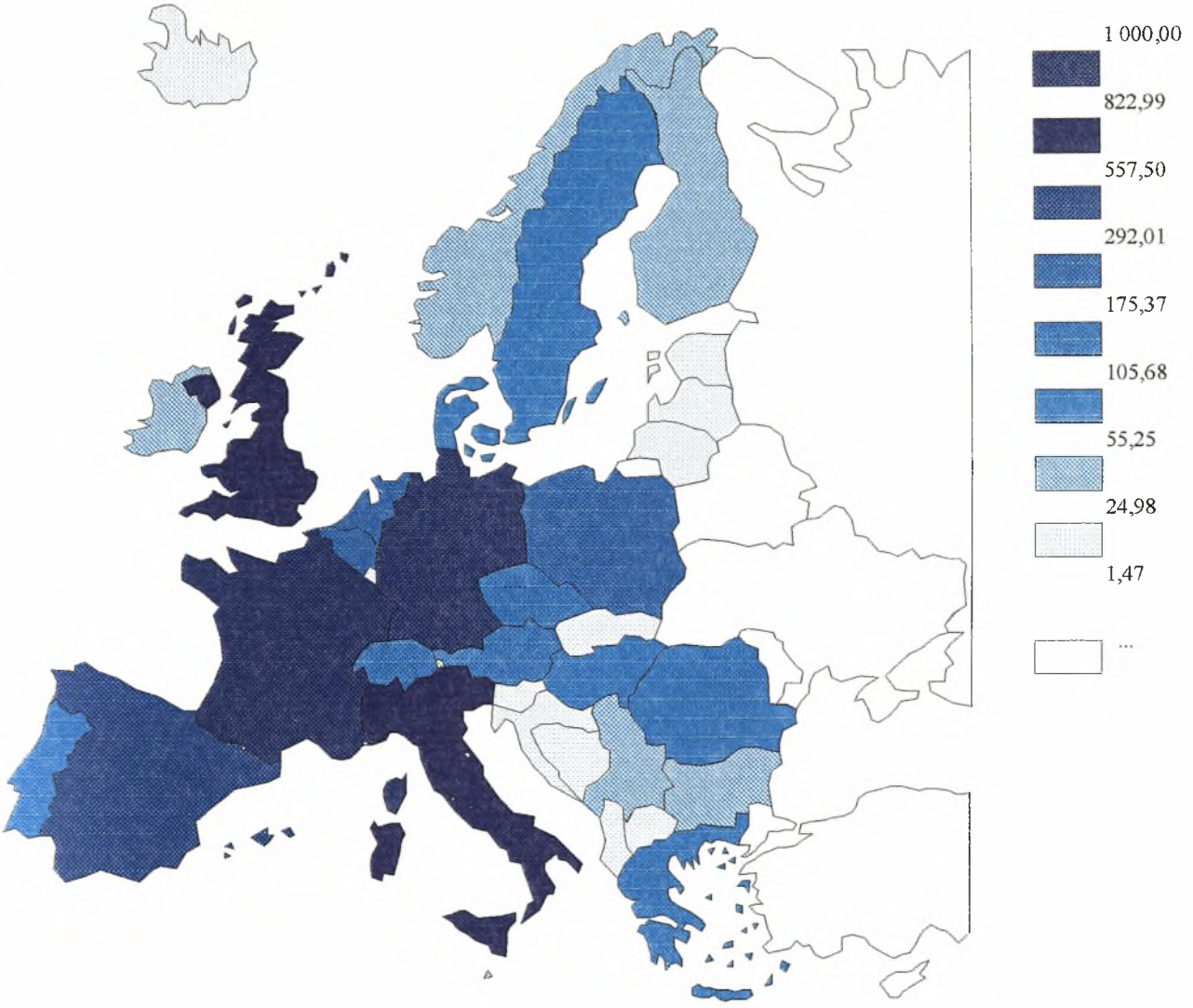
Figure 2. Population Potential Levels in Central and Eastern Europe in the Short-term and the Long-term Scenario



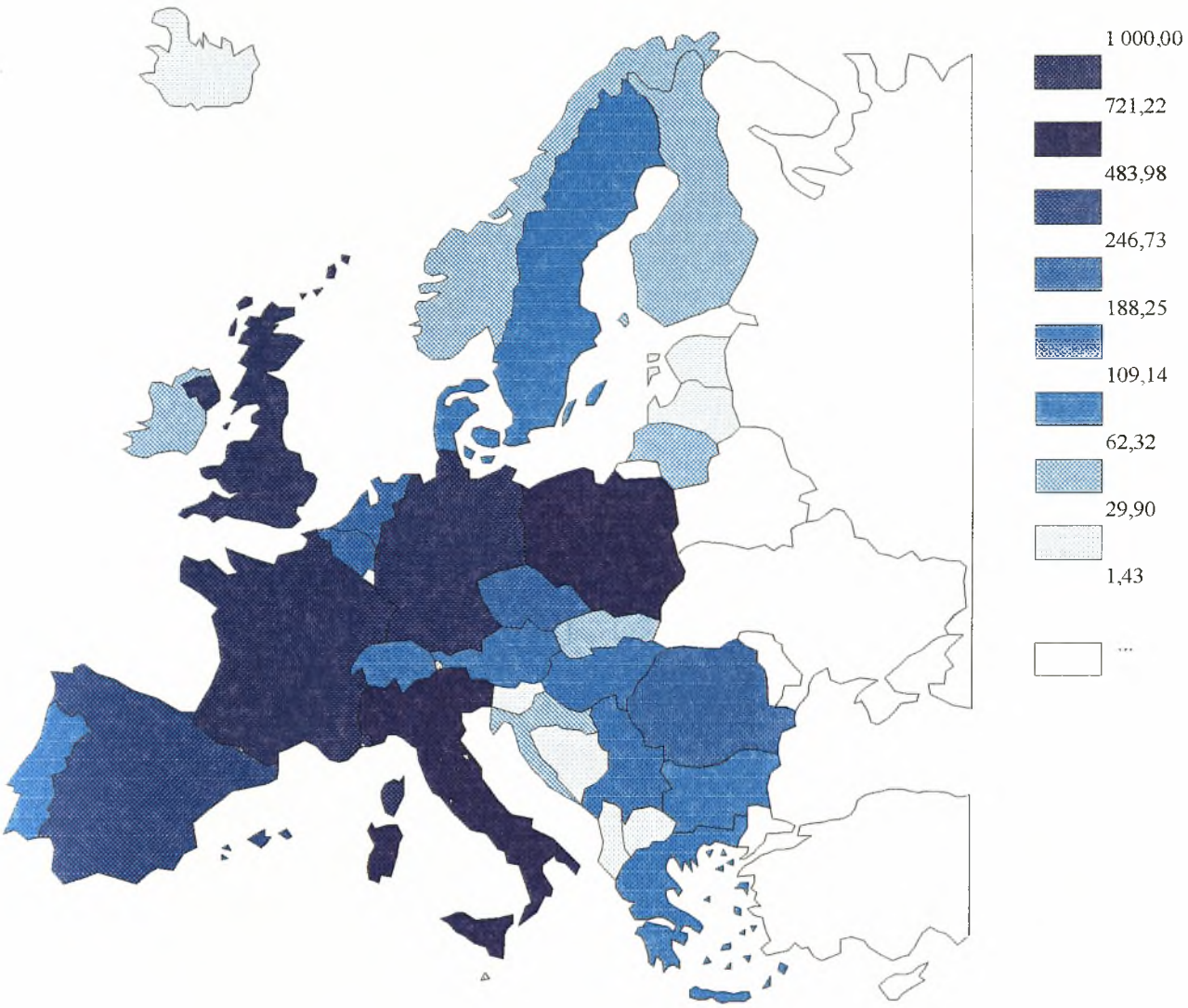
Map 1. Spatial Order of Economic Potential in the pre-1989 Western Europe (Gravity Index)



Map 2. Spatial Order of Economic Potential in the New Europe
(Gravity index: the short-to-medium term perspective)



Map 3. Spatial Order of Economic Potential in the New Europe
(Gravity index: the long term perspective)



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Πεδίον Άρεως, Βόλος 38334

UNIVERSITY OF THESSALY
DEPARTMENT OF PLANNING AND
REGIONAL DEVELOPMENT
Pedion Areos, Volos 38334, Greece