The Role of Institutional Capacity in Fostering Economic, Territorial and Social Cohesion in the Danube Region

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Abbreviations

CEI	Central European Initiative
CF	Cohesion Fund
CLLD	Community-led Local Development
COMECON	Council for Mutual Economic Assistance
CoR	Committee of the Regions
CPR	Common Provision Regulation
CSF	Common Strategic Framework
CSR	Country-specific recommendation
DG	Directorate-General
DG EMPL	Directorate-General for Employment and Social Affairs
DG NEAR	Directorate-General Neighbourhood and Enlargement Negotiations
DG REGIO	Directorate-General for Regional and Urban Policy
EaSI	European Programme for Employment and Social Innovation
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EESC	European Economic and Social Committee
EGTC	European Grouping for Territorial Cooperation
EIB	European Investment Bank
ENI	European Neighbourhood Instrument
ESF	European Social Fund
ESIF	European Structural and Investment Funds
EP	European Parliament
ERDF	European Regional Development Fund
ETC	European Territorial Cooperation
EU	European Union
EUSAIR	EU Strategy for the Adriatic and Ionian Region
EUSALP	EU Strategy for the Alpine Region
EUSDR	EU Strategy for the Danube Region
EUSBSR	EU Strategy for the Baltic Sea Region
FDI	Foreign Direct Investment
GAC	General Affairs Council
GDP	Gross Domestic Product
HDI	Human Development Index
IP	Investment Priority
ITI	Integrated Territorial Investment
JAP	Joint Action Plan
MFF	Multi-annual Financial Framework
MRS	Macro-regional strategies
MS	Member State
NIE	New Institutional Economics
NMS	New Member State
NUTS	Nomenclature des unités territoriales statistiques
OECD	Organisation for Economic Cooperation and Development
OP	Operational Programme
PA	Partnership Agreement
PAR	Public Administration Reform
QoG	Quality of Government
RCC	Regional Cooperation Council
R&D	Research and Development
TAIEX	Technical Assistance and Information Exchange Instrument
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TO11	Thematic Objective 11 “Enhancing Institutional Capacity”
YEI	Youth Employment Initiative

Country abbreviations are used in accordance with the interinstitutional style guide (ISO 3166).

Figures

0. Introduction

The present work builds upon the author's experience in the framework of the first five years of the implementation of the EU Strategy for the Danube Region (EUSDR) within the coordination of the Priority Areas 9 "Investing in People and Skills" and 10 "Stepping Up Institutional Capacity and Cooperation". The Danube Region is a region that was particularly hit by major conflicts in the 20th century and suffered from different kinds of totalitarianism. It is also a region that has been within the sphere of interest of three major empires: the Habsburg, the Russian and the Ottoman empires. Nowadays, the region comprises EU Member States as well as (potential) candidate countries and countries of the European Neighbourhood. The EU has seen two major enlargement rounds in 2004 and 2007/2013, with a total of ten new Member States joining in 2004, two in 2007 and one in 2013. The policies of EU enlargement face significant challenges between, on the one hand, geopolitical competition with other powers such as China, Turkey or Russia, which invest in Southeast Europe, and on the other the EU's capacity to integrate countries whose economic performance is below the EU average.

This puts not only the EU's external policy to a test, but also its Regional Policy, whose primary focus has shifted from Europe's South to its East. It is the main task of the EU Regional Policy and the Structural and Investment Funds (ESIF) to deliver on the goal of economic, territorial and social cohesion in accordance with article 3 of the TEU and articles 174-177 of the TFEU. With roughly a third of the EU budget, the EU's Regional Policy is its main investment policy. In many of the new Member States (NMS) in Southeast Europe, (e.g. Romania and Bulgaria) EU investments are the main source of public investment. In addition to the ESIF in the Member States, the EU also invests in the third countries through the Instrument for Pre-Accession Assistance (IPA) in the (potential) candidate countries as well as the European Neighbourhood Instrument (ENI) in the Neighbourhood countries.

Nevertheless, in Southeast Europe, Structural and Cohesion Policy has so far failed to create such territorial, economic and social cohesion and equilibrate the disparities in the EU. This also applies to the Enlargement Policy on the Western Balkans as well as the Neighbourhood Policy in the Republic of Moldova and in Ukraine. Within all these dimensions – cohesion, enlargement, and neighbourhood – it is widely recognised that besides the shift of Regional Policy towards a shared management between the Commission and the Member States (cf. art. 4 TEU), the lack of institutional capacity is one of the main reasons for the challenges these policies face in Southeast Europe, be it in the framework of the European Semester or in the reports of DG NEAR.

Under the umbrella of a newly introduced so-called macro-regional strategy, the Danube Region again is following a common political path that comes on addition to the legal and financial framework of the ESIF. Stemming from the EU Strategy for the Baltic Sea Region (EUSBSR), the EU Strategy for the Danube Region (EUSDR) intends to contribute to establishing cohesion in Southeast Europe and also to find new ideas of investment. To a certain extent, macro-regional strategies operate without the constraints of mainstream EU Policies and form new transnational networks that function as knowledge hubs or think-tanks with an innovative mix of bottom-up and top-down strategies, including public institutions, civil society and academia.

The present work intends to enquire as to what can be done and which steps can be envisaged in order to reach a realistic approach to establish cohesion in the Danube Region. This comprises a threefold approach.

First, an assessment of current trends in theories of Institutional economics as well as in Regional Development in the EU shall be carried out. This assessment deals with the question: W*hat should be done?*

The first part is divided into two major steps: first, it intends to give an overview of the role institutions might play in economic theory, especially in new institutional economics. This first step shall provide a rather diachronic point of view of economic development and draw upon a point of view where the market is seen as integrated into the broader economy, and this broader economy embedded into the society (cf. Polanyi et al. 2010).

The second part shall reflect upon current trends in theories of regional development. It shall provide insights into major approaches for investment in the context of the EU institutional setting. One major element shall be to argue that institutional capacity is strongly related to regional development and multi-level governance. Second, it shall assess the geographical scope of this study which is mainly Southeast Europe and give an overview of the economic development in the new Member States (NMS), the IPA and the ENI countries. In addition to this synchronic analysis, it is essential to provide also a diachronic point of view on the transformation processes in post-totalitarian regimes, which shall contribute to understand the challenges in developing institutional capacity.

Secondly, an assessment of existing tools within the European Structural and Investment Funds (ESIF), the Instrument for Pre-Accession II (IPA) and the European Neighbourhood Instrument (ENI) shall be carried out. It shall provide answers to the question: *What is being done?* This second part shall give an overview on existing funding mechanisms in the current multi-annual financial framework (MFF) and analyse to what extent institutional capacity development is considered in the Operational Programmes (OPs) of the ERDF (including territorial cooperation), the ESF, as well as the IPA and ENI programmes. It shall also consider current initiatives to reform Cohesion Policy and try to assess new instruments such as the TAIEX Regio peer-to-peer or simplification measures as well as new approaches in the framework of the recent review of the neighbourhood policy and the new EU enlargement strategy.

Thirdly, an outlook and recommendations shall be provided and try to give answers to the question: *What should be done?* This third and last part of the study aims at delivering policy recommendations and assessing options for the future by comparing the evidence base of part 1 to the existing policies and instruments examined in part 2. Moreover, it will draw upon the experiences of pilot projects carried out by the City of Vienna and requested by the European Commission in the fields of seed funding and technical assistance. This last part will argue that policies should respond to the real needs of the economy and that institutional capacity development has a crucial role to play when it comes to ensuring a climate favourable for business, FDI, and the creation of value chains. Moreover, it will be emphasized that the current instruments and policies do not meet the real needs of many of the economies in Southeast Europe, and that these policies should comply with the requirements for good governance, including micro-finance tools, inclusion of civil society and local authorities, and fair pay schemes in the public sector.

As mentioned above, the framework of this text and the context from which it stems is the EU Strategy for the Danube Region (EUSDR) and the author's experience in the coordination of the Priority Areas 9 "Investing in People and Skills" and 10 "Stepping up Institutional Capacity". Hence, the geographic scope covers the 14 countries of the Danube Region, a so-called macro-region of which nine are EU-Member States (AT, BG, CZ, DE, HR, HU, RO, SI, SK), two candidate countries (ME, RS), one a potential candidate (BA) and two countries of the European Neighbourhood (MD, UA).

1. Institutions in economic theory

In his book “Les Trente Glorieuses” written in 1979 (Fourastié impr. 2011), Jean Fourastié compared two imaginary villages in Europe, Madère and Cessac. One, Madère, was supposed to be in Southeast Europe or Portugal and at a low level of development, with activities mainly related to agriculture, whereas the other, Cessac, was already highly developed. Fourastié concludes that both villages are actually one and the same, namely Douelle en Qercy – Madère only represents Douelle in 1946 and Cessac is Douelle in 1975. Fourastié thereby creates the legacy of the thirty glory years of France, where it was transformed from a mainly agricultural nation into an industrial one, with average growth rates of approximately 5%.

The present text is not about disparities in terms of time, it is about the territorial disparities and how gaps in territorial cohesion can be closed in order to comply with the aforementioned goal of territorial, social and economic cohesion enshrined in the primary law of the European Union. In other words, the present text is not about Douelle, but about how Madère can become Cessac.

One major feature in economic development is institutions and their functioning. The enlargement rounds in 2004, 2007, and 2013 have not only significantly increased the EU’s geopolitical weight, they have also altered its internal configuration, with new Member States with lower levels of economic cohesion and a common totalitarian past, mainly in the real existing socialism. These, despite their high levels of centralization, have not established inclusive institutions, but informal ones such as grey economies, low levels of the rule of law, and behavioural settings that are not conducive to development. Amartya Sen comments on the role of institutional settings in economic development. What he states about developing countries largely holds also for the Danube Region:

> [T]he developing countries have to pay attention not only to the virtues of prudential behavior, but also to the role of complementary values, such as the making and sustaining of trust, avoiding the temptations of pervasive corruption, and making assurance a workable substitute for punitive legal enforcement (Sen 2001: 267).

Sen states that capitalism has not only the capacity to unfold economic potential, but that it also transforms codes of behaviour in order to make market transactions more effective. However, he believes that common issues such as the environment will take people to institutions that are “beyond the market economy” (ibid.). Moreover, a dysfunctional market economy with weak economic and political institutions may create alternative forms of sovereignty, such as the Mafia in Italy, where the effective reach of the government is limited. Sen then argues that a functioning market cannot be sustained by respective legal settings if there is not accompanying ethics, since business requires trust and the enforcement of contracts, i.e. trust is required in order to enforce laws. This assumption puts institutions at the heart of economic development, as they are at the interfaces of the social, the political and the economic sphere; they define the mutual embeddedness of a society and an economy. Sen argues that the Mafia is a functional element of a dysfunctional economy, as it triggers the enforcement of 'contracts' and challenges the monopoly of violence of the state. Once the state manages to build trust and the enforcement of contracts, the mafia becomes redundant.

Why is this relevant for the Danube region? Most countries of the Danube Region face a similar past in the real existing socialism, which has engendered similar features such as:

- low-trust societies;
- lack of rule of law;
- highly centralised structures;
- high share of the grey economy;
- high levels of corruption;
- culture of authoritarianism (also related to regimes preceding socialist ones);
- ethnicised politics, populist and nationalist movements;
- relevant impact from other foreign powers, such as the USSR with its economic system COMECON, the Ottoman and Austro-Hungarian empires, the Russian Empire and a culture influenced by authoritarianism.[1]

Despite the above-mentioned high degree of centralization of power structures, the weak institutions left behind did not lead to closing the gaps in terms of development, and many of the mentioned countries reached the GDP levels they possessed at the end of Communism only 15 years later. In the following 3 chapters, some approaches in economic theory which highlight the question of institutions shall be examined. It shall be argued that well-

[1] For instance, Habsburg emperor Francis I. told teachers in Ljubljana: "I do not need savants, but good, honest citizens. Your task is to educate young men to this ideal. He who serves me must teach what I order him. If anyone can't do this, or comes with new ideas, he can go, or I will remove him." (quote from Acemoglu and Robinson (2013: 223))

functioning administration and respective ethics are crucial when it comes to enabling sound investments.

There are three models which enable us to understand the reasons why some regions are poor and some others are rich. First, 'new geographic economy' models emphasize the role of market effects on the emergence of core regions and regions lagging behind. The second model focuses on innovation, i.e. aspects of endogenous growth. The third school emphasizes the role of institutions as key drivers of economic development, as well as vicious circles stemming from the lack of incentives to change institutional settings. The present study focuses primarily on this aspect - on how institutional patterns affect economic growth (Farole et al. 2011: 1092–3).

Among economists, there are typically two prevailing approaches concerning the role of institutions in economic and social development. The first approach advocates that institutional capacity is a result of economic development. Opposed to this view, the second approach suggests that well-functioning institutions are not a sufficient but a necessary pre-condition for economic development (cf. Acemoglu and Robinson 2013). In the present study, this shall be showcased via an analysis of the institutional capacity in the Danube Region. The second approach is currently gaining influence in academia (cf. Rothstein 2011, Garcilazo and Rodriguez-Pose 2013) and is also increasingly considered by the Commission (see European Commission 2014b).

1.1. New Institutional Economics (NIE)

1.1.1. Douglass C. North

The first author to be examined is Douglass C. North, as a major contributor to “New Institutional Economics” (NIE), a current in economic theory which mainly focuses on the role of contracts and social norms, and their place in economics. One starting point for NIE is Ronald Coase’s article “The Nature of the Firm” (Coase 1937). Coase explores the reasons as to why a firm is actually necessary, if it is assumed that markets are supposed to be perfect. The essential question in this approach is why firms do not contract out but actually hire. Coase argues that transaction costs such as costs for information, bargaining or keeping trade secrets etc. may arise, all of which need to be avoided - which is why the firm or institutions are necessary in the first place.

Pike et al. define the ‘institutionalist’ approach as follows:

> Influenced by the broader ‘old’ institutionalism of Polanyi and Veblen […] and the ‘socio-economics’ of the ‘new economic sociology’ […], the emergent work has focused upon the embeddedness of social action in ongoing systems of social relations and the social and institutional context of local and regional growth […]. Formal (e.g. organisations, administrative systems) and informal (e.g. traditions, customs) institutions are interpreted as integral to reducing uncertainty and risk as well as promoting trust in economic relations (Pike et al. 2009: 91).

For Douglass C. North, the most important message from Coase’s article is that “when it is costly to transact, institutions matter.” North builds upon this notion of transaction costs when defining the institution in his book “Institutions, Institutional Change and Economic Performance” published in 1990 (North 2009). He states that the major role of institutions within a society is to “reduce uncertainty by establishing a stable (but not necessarily efficient) structure to human interaction” (p. 6). In this regard, it is important to clarify the difference between institutions and organisations. While organisations include all political bodies (e.g. schools or political parties or firms), institutions are the underlying rules for the functioning of organisations, the latter being the main drivers for institutional change. For North, institutions are crucial in order to understand the costs of exchange and production which they affect together with the technology. As the determinant of economic performance and relative price changes, they create a path of institutional change and thereby continually alter our potential choices. This path dependence (and this is of particular relevance in our macro-regional context of the Danube Region) is not necessarily productive:

> [U]nproductive paths persist. The increasing returns characteristic of an initial set of institutions that provide disincentives to productive activity will create organizations and interest groups with a stake in the existing constraints. They will shape polity in their interest (North 2009: 99).

North does not see institutional change as being correlative with economic growth or technical progress. When entrepreneurs in economic and political organizations perceive that they could do better, this leads to what North calls "incremental change". However, this change, together with the fact that not all the consequences of policies are always foreseeable, leads to North's understanding of institutions as assembling activities that both increase *and* decrease productivity. A good example is the political changes after the end of Communism, where a considerable institutional change did not - at least not immediately - lead to more productivity, but to an economic recession (which was of course also due to external factors).

For North, institutions are "regularized actions that reduce uncertainty" (ibid, p. 23); they provide a setting where choices are taken unconsciously. This can be considered as a main feature that makes economic exchange possible. North distinguishes three different types of economic exchange (p. 34): firstly, there is *personalized exchange*, which has characterized most of economic history. This features mostly local trade and small-scale exchange and trading partners with high levels of mutual trust and repetition. With increasing quantities of exchanges, the second pattern of exchange emerges, *impersonal exchange*, which marked the first form of long-distance trade in the early Middle Ages in Europe. Modern economies are characterised by the third kind of exchange, *impersonal exchange with third-party enforcement*, which requires an effective judicial system. Institutional development is characterised by these three steps, i.e. the development of informal constraints, formal rules, and enforcement through third parties.

North widely criticizes neoclassical theory. He opposes the neoclassical assumption of a market with perfectly informed participants and a setting of institutions without frictions. For a prosperous path dependency of a nation state or a region, competition among political units is essential. North proposes to build upon Karl Marx by integrating the institutional and technological factors not as exogenous ones, but rather without the utopian end that Marx advocated (North 2009: 130–2). Regarding the aforementioned three steps and the relevant experiences of the countries in the Danube Region during the post-socialist transformation, it must be stated that the emergence of a grey economy and related challenges in a new system (e.g. in Romania or in Bosnia & Herzegovina during the war) provide us with the insight that if third-party contract enforcement fails, countries can fall back into impersonal exchange based upon customs or even personal economic exchange. North writes that

> [I]nstitutions determine the performance of economies, but what creates *efficient* institutions? Clearly the existence or relatively productive institutions somewhere in the world and low-cost information about the resultant performance characteristics of those institutions is a powerful incentive to change for poorly performing economies. That appears to be the case in the striking changes in Eastern European societies in 1989 (North 2009: 137).

Nevertheless, North also builds upon neoclassical theory and sees his approach as complementary to this tradition of economic theory. North provides an approach that should connect microlevel economic activity with the "macrolevel incentives provided by the institutional framework" (North 2009: 112).

> If the basic institutional framework makes income redistribution (piracy) the preferred (most profitable) economic opportunity, we can expect a very different development of knowledge and skills than a productivity-increasing (the twentieth-century chemical manufacturer) economic opportunity would entail. Extreme examples yes, but as ideal types they do typify much of economic history. The incentives that are built into the institutional framework play the decisive role in shaping the kinds of skills and knowledge that pay off (North 2009: 78).

This statement can be seen as crucial for the chapters that follow. These deal mainly with EU investment in Southeast Europe. It shall also be examined to what extent EU investments create new incentives and thereby establish a spill-over that goes beyond the initial investment. The complexity of the EU system requires a sound multi-level governance system, which should be – despite its complexity – at the same time highly efficient and also create the appropriate incentives in order to foster smart, sustainable, and inclusive growth.

> The more resources that must be devoted to transacting to assure cooperative outcomes, the more diluted are the gains from the trade of the neoclassical model. The more complex the exchange in time and space, the more complex and costly are the institutions necessary to realize cooperative outcomes (North 2009: 58).

We consider this in our context of the Danube macro-region, i.e. an environment where the largest national investment in the EU Member States comes from the ESIF. These five funds exist in a legal framework whereby each fund is defined in a specific regulation (European Commission 2015c). Moreover, there is a common strategic framework also laid down in a common provision regulation (1303/2013) as well as a specific regulation for the European Territorial Cooperation goal (ETC) of the ERDF and the European Grouping of Territorial Cooperation (EGTC). In addition to these regulations, each of the EU Member States negotiates a Partnership Agreement, where the investment priorities are laid down, especially in relation to the European Semester. This specific setting and what it means will be dealt with in part 2. For the time being, it is sufficient to state that the system is complex, and to raise the question of whether this complexity leads to additional costs, or whether it fosters a behaviour that is conducive to smart, sustainable and inclusive growth in the Danube Region. The crucial question here is whether such public investment is capable of triggering a system that ultimately leads to the rule of law, i.e. what North calls impersonal economic exchange with third-party enforcement.

Nevertheless, it remains unclear what added value the notion of the ‘institution’ can really provide at the margins of economic theory and social sciences. North states that “[w]e cannot see, feel, touch, or even measure institutions; they are constructs of the human mind. But even the most convinced neoclassical economists admit their existence and typically make them parameters (implicitly or explicitly) in their models” (North 2009: 107). In this regard, it is vital to understand institutional settings in order to understand economic development. Nevertheless, it is not sufficient to focus only on institutions as *modus operandi* of economic and political organizations. Moreover, the transferability of institutional frameworks between nations and regions, e.g. between successful and lagging or remote regions like in the Danube macro-region, remains questionable (Pike et al. 2009: 95).

North defines institutions as a “basic structure throughout history that provides societies with the potential to reduce uncertainty”. They are key when it comes to determining a path dependency and defining the costs of transformation. North also states that they are essential for understanding the relationship and interdependence of polity and economics (North 2009: 130). Efficient institutions are produced by “a polity that has built-in incentives to create and enforce efficient property rights, but it is hard – maybe impossible – to model such a polity with wealth maximizing actors unconstrained by other considerations. [...] The state becomes nothing more than a machine to redistribute wealth and income” (North 2009: 140).

The latter seems to be the case when we discuss the effectiveness of ESIF within the EU. For instance, many actors in the field would state that the financial management of EU projects has become more important than its actual content. In North’s terminology, one might say that in Southeast Europe, we are confronted with unhealthy competition between formal and informal institutions. Institutions need to be inclusive in order trigger economic development, which is the main line of thought of the next subchapter. For North, it is the “scaffold” of the society that determines the path dependence of an economy: “When the scaffolding crumbles, as it did in Eastern Europe in 1989, the problems of constructing a new framework have exposed our limited understanding of the process of change" (North 2008: 27).In this respect, it can be stated that the transformation challenges we are still facing in some countries and regions of Southeast Europe reveal also a general knowledge about the interaction between the economy, politics, and the society.

Nevertheless, NIE did not play a major role in the early years of transformation (cf. Murrell 2008).

1.1.2. Acemoglu/Robinson: Why Nations Fail

One of the most prominent accounts of NIE has been given by Daron Acemoglu and James A. Robinson in their book *Why Nations Fail* (Acemoglu and Robinson 2013). Like Fourastié in his book on the *Trente Glorieuses* of France, they start their analysis with a description of a small town called Nogales, which is divided between the USA and Mexico. While Nogales in the US shows a decent degree of development, the situation in Mexican Nogales is less favourable.

Acemoglu and Robinson bring up several popular hypotheses why some nations are wealthier than others. First, they object to the justification of these differences through geographic (e.g. natural resources) or cultural (religion, attitudes) reasons. Moreover, they argue that the lack of knowledge is not the reason for policies that reduce market failures. Finally, they identify the lack of inclusive institutions as the main obstacle to achieving growth and prosperity (Acemoglu and Robinson 2013: 45–69).

> Just like the geography hypothesis, the culture hypothesis is also unhelpful for explaining other aspects of the lay of the land around us today. There are of course differences in beliefs, cultural attitudes, and values [...]. [T]hese differences are consequences of the two places' different institutions and institutional histories (Acemoglu and Robinson 2013: 63).

The authors thereby reject approaches like the Weberian one, where the market economy is related to Protestant ethics (Weber 2006). Places like Nogales could also be found in the Danube Region – one might think of the Bad Radkersburg in Austria and Gorna Radgona in Slovenia, a city that was divided after the First World War. Another example would be Vienna and Bratislava, with Bratislava levelling at 182% of average EU GDP (PPP) on the NUTS2 level € in 2014 and Vienna only at 158%.[2] Acemoglu and Robinson seek the roots

[2] Eurostat data, 2014.

of inequality and develop a system of extractive and inclusive economic and political institutions.

Institutions	Inclusive	Extractive
Political	Enforce property rights Create level playing field Encourage investments in new technologies Distribution of power Pluralism	Fail to protect property rights Concentrate power in the hands of the few
Economic	Produce growth Provide inventives for economic activity	Growth absent or not sustainable Extract ressources from the many to the few Do not provide incentives
	Virtuous circle	Vicious circle

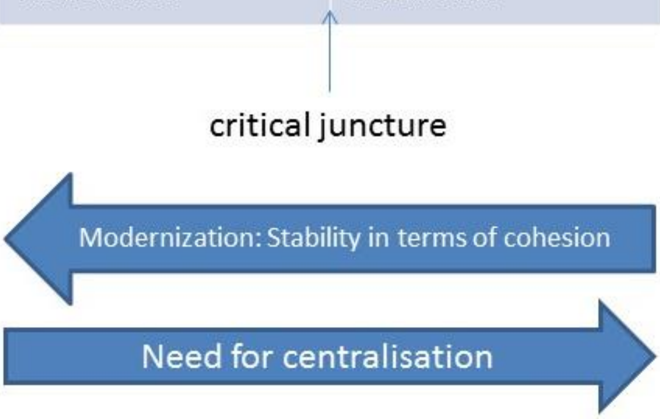


Figure 1 Institutions according to Acemoglu/Robinson (developed by the author)

The system allows for a comprehensive analysis of nations. Some nations may have inclusive economic institutions but non-inclusive political institutions, as was the case in South Korea or Chile in the 1980s. Some nations may be characterised by inclusive political institutions but extractive economic ones. However, unlike in North's approach, (North 2008) it is first and foremost the inclusive the economic institutions that pave the way for political freedom:

> The ability of economic institutions to harness the potential of inclusive markets, encourage technological innovation, invest in people and mobilize the talents and skills of a large number of individuals is critical for economic growth (Acemoglu and Robinson 2013: 79).

It must be noted that extractive institutions support each other on the political and economic level: "Nations fail when they have extractive economic institutions, supported by extractive political institutions that impede and even block economic growth" (Acemoglu and

Robinson 2013: 83). Nevertheless, countries with extractive institutions can reach a limited amount of economic growth by for example shifting activities between sectors, as it was the case of the USSR when the country was industrialized. This leads the authors also to the prognosis that growth in China cannot be sustainable, as it does not provide inclusive political institutions. When both economic and political institutions are extractive, as is the case e.g. in North Korea, there are no incentives for what Schumpeter has called "creative destruction" (*schöpferische Zerstörung*).[3] This process is related not only to technological progress, but also to advancements in terms of organization, i.e. what North calls incremental change of institutions. Prosperity can be achieved only by solving political problems. Economics alone cannot solve the problem of world inequality because it assumes that political problems are already solved (Acemoglu and Robinson 2013: 68–9). This is interesting approach when assessing e.g. the shortcomings in EU regional integration in the Danube Region in the aftermath of the enlargement rounds of 2004, 2007 and 2013. The Danube Region can be seen as a region that is still characterised by extractive institutions. These extractive institutions "are so common in history because they have a powerful logic: they can generate some limited prosperity while at the same time distributing it into the hands of a small elite. For this growth to happen, there must be political centralization" (Acemoglu and Robinson 2013: 149). This is the kind of growth that is currently occurring in the Danube Region. In many countries, the elites even directly or indirectly stem from the communist period.

In the context of regional development and the implementation of EU policies, many of the Danube countries still suffer from high degrees of centralization, a heritage from the real existing socialism. For instance, when it comes to EU investment, for many communities in the Danube Region it is easier to acquire subsidies from programmes that are centrally managed in Brussels than from those that are managed in their own capitals. Centralisation can be considered as a

[3] Schumpeter rejects the idea that perfect markets ever existed and were later corrupted towards markets with oligopolies or monopoles. He sees capitalism rather as an evolutionary process, which is not primarily altered by the fact that economic 'life' is embedded into a human and natural environment. It is rather technological progress as well as new methods and organisations of industrial production that keeps capitalism alive. The process of creative destruction is a process that revolutionizes the economy from within and can be seen as an essential feature of capitalism. Schumpeter insists that we are dealing with an organic *process* which unfolds over centuries, similarly to North's 'incremental' change of institutions. Schumpeter criticizes economics textbooks and states that what matters more than price competition is competition of technologies and organizations, since this has more long-term effects. For instance, groceries will not destroy each other, but new forms of retailers such as supermarkets will destroy groceries (see Schumpeter (2008: 81–6)).

> “major dividing line between extractive political institutions. Those without it [...] will find it difficult to achieve even limited growth. Even though extractive institutions can generate some growth, they will usually not generate sustained economic growth, and certainly not the type of growth that is accompanied by creative destruction. When both political and economic institutions are extractive, the incentives will not be there for creative destruction and technological change (Acemoglu and Robinson 2013: 94).

What does this ‘Schumpeterian’ approach mean for Southeast Europe?

For Acemoglu/Robinson, it is not primarily the ‘communist’ historical experience which has created a division between Western and Eastern Europe:

> [A]fter Black Death, Western Europe significantly drifted away from the East. Documents such as the Magna Carta started to have more bite in the West. In the East, they came to mean little. In England, even before the conflicts of the seventeenth century, the norm was established that the king could not raise taxes without the consent of Parliament (Acemoglu and Robinson 2013: 209).

For the authors, it is the pressure resulting from the insufficient labour force after the Black Death which led to inclusive institutions in Western Europe. Empires that have significantly dominated the Danube Region, such as the Austro-Hungarian, Ottoman or Russian empires, never or only reluctantly implemented inclusive economic and political institutions. At the same time, some nations were able to take advantage of the industrial revolution and the respective organizational methods that come with it (Acemoglu and Robinson 2013: 94). It is not the lack of knowledge of politicians that leads to the non-adoption of appropriate policies, but rather the lack of incentives for the elites to do so (Acemoglu and Robinson 2013: 446). The success of nations is ensured through the establishment of *institutional thickness*, i.e. “a strong institutional presence locally, high levels of inter-institutional interaction, strong social structures and collective awareness of a common local and regional enterprise” (Pike et al. 2009: 94). It is precisely these elements which are currently lacking in the Danube Region; these societies are primarily based upon the proactive individual, be it in the institutional sphere, economic activities, or civil society involvement – all these components are crucial in order to make European integration and enlargement in the Danube Region a reality. However, many countries in the Danube region suffer from the emigration of well-educated young people (brain drain) and birth rates that are among the lowest in the entire world. Are some of these nations about to fail? The answer given by Acemoglu/Robinson is quite clear:

> Nations fail today because their extractive economic institutions do not create the incentives needed for people to save, invest, and innovate. Extractive political institutions support these economic institutions by cementing the power of those who benefit from the extraction (Acemoglu and Robinson 2013: 372).

The following parts of this work intend to examine to what extent countries in the Danube Region are able to establish inclusive institutions. Following a regional development approach (Pike et al. 2009), lagging regions (and apart from the capital regions, most of the regions in the Danube macro-region are indeed lagging), there are only three options for sustained development: a) a cheap labour force, an effect which might be jeopardized by the medium-income trap and respective effects of globalisation; b) tourism, which requires a certain degree of rule of law and qualified human resources; c) innovation, which requires high degrees of organisation, e.g. relations between industry and academia, as well as highly skilled people. Rodríguez-Pose identifies the main innovation bottlenecks in the periphery of Europe. These are mainly human capital deficits, the lack of vocational training schemes and/or educational reform, brain drain (which particularly affects the rural regions in Southeast Europe), weak economic fabrics, (e.g. weak SMEs with the majority in rather traditional sectors) and, not least, and this matters specifically in our context, deficient institutional settings, which causes innovation systems in particular to suffer. The author argues that investment in R&D in lagging regions triggers almost no returns, with institutional capacity being the pre-condition for such return on investment (Rodríguez-Pose 2015: 20–1).

1.2. Institutions in Regional development

As previously mentioned, institutions play also a crucial rule in regional development. In this regard, EU Regional Policy aims at fostering social, territorial and economic cohesion. Another principle that is enshrined in the Treaties is *subsidiarity* (art. 5 TEU). Regional development approaches have seen a considerable shift from top-down to bottom-up approaches, in order to make economic and political institutions more inclusive, to cope with the disparities within a country, and at the same time with the challenges of globalisation.

All the aforementioned aspects suggest that there is a strong, if not direct link between regional development and institutions. In his article containing the emblematic question “Do institutions matter for regional development?”, Andrés Rodríguez-Pose argues that the importance of institutions for regional development has been overlooked, and that classical economic theories tend to privilege 'hard' infrastructure investments (Rodríguez-Pose

2013).[4] He argues that if the effectiveness of regional development is controversial, and if researchers point out that institutions matter for it, development strategies should consider it to a wider extent. An effective government may be understood in this context as the combination of social capital and institutional 'thickness', i.e. a combination of the active presence of institutions with shared values and lively interactions. The institutional setting and performance in the post-communist states was extremely weak, and after an economic downturn many of these states reached the GDP they had in 1990 only 10 years or more later.

According to Rodríguez-Pose, it is essential to design appropriate institutional settings for regional development. Yet the question arises as to whether there should be a one-size-fits-all model for regional development or tailor-made solutions for each region, which might be costlier. The experience of ESIF in Southeast Europe, especially in Romania and Bulgaria, shows that a solution that was mainly designed for Western Europe is not necessarily applicable in Southeast Europe, although the Baltic states and Poland demonstrate that there can be real and sustainable benefits from the EU's Regional Policy. Historical aspects during the transition phase might be very relevant for building institutional capacity, e.g. an early civil society movement in Poland and new (ethnic) elites in the Baltic States, whereas in Southeast Europe formal and non-formal institutions jeopardize regional development.

The main questions which will be addressed in the upcoming chapters are thus whether a) institutional capacities can be measured, b) to what extent they influence regional development and c) whether a place-based approach or a place-neutral one is required. In the well-known Barca report for a new cohesion policy (Barca 2009), Fabrizio Barca advocates though a place-based approach, calling for a balance of endogenous and exogenous forces in order to foster growth in lagging regions. This aspect also highlights the fact that the EU enlargements in 2004 and 2007 (and 2013 for Croatia) failed to deliver on the readiness for European integration in terms of territorial, social and economic cohesion. The main reason for this might be the fact that enlargement rounds were driven by geopolitical reasons rather than economic ones. Moreover, there is not yet a specific urban policy of the EU, although there was a communication by DG Regio and ministerial meetings in Riga and Luxemburg as well as respective efforts under the Dutch EU

[4] For example, one result of this is that stakeholders from the NMS report that an infrastructural facility, e.g. for wastewater management, is built via ERDF programmes, but afterwards neither the national funding for maintenance nor the human resources to run the facility can be provided.

presidency in 2016. This is despite the fact that more than 70% of the EU's population is urban-based. Nevertheless, Barca identifies agglomerations, especially medium-sized cities, as the main drivers of economic development. Moreover, the Regional Policy of the EU is widely adapted to institutional settings of the Western States in the EU. Barca (Barca et al. 2012) argues that for "the EU-12 most recent accession countries, the picture is one of relatively poor institutions, many of which were destroyed or undermined under socialism, and which once again are highly heterogeneous" (Barca et al. 2012: 143). The place-based approach advocates specific solutions adapted to a specific relationship between a region and institutions, and thereby argues for multiple ways of development, taking into consideration the specific circumstances of the European Union.

Hence, in order to deliver policies on the ground, it is essential that the regional development in the region complies with the principle of multi-level governance (MLG). MLG implies not only vertical consistency (e.g. between different layers of government), but also horizontal consistency (e.g. through the involvement of NGOs). MLG can be understood as

> [S]tructures of government and governance are evolving into multilevel, often devolving systems, working across and between the local, regional, subnational, national and supranational scales. Existing institutions have been reorganised, new institutions have emerged and new relations, often based around 'partnership', have dominated the governance of local and regional development (Pike et al. 2009: 3).

In the practice of European governance, this means that the so-called partnership principle of the EU is being applied on the levels of both partnership agreements (PAs) and operational programmes (OPs), e.g. the respective country's ESF involves social partners or the ERDF local and regional authorities. MLG is firmly embedded in the common provisions regulation for ESIF (regulation 1303/2013, article 5).

The relationship between MLG and its actors is mutual, and MLG might help to address precisely the issue of remote regions with low levels of territorial and social cohesion as well as highly centralised states with extractive institutions. It thereby leads to a specific form of 'soft' empowerment:

> The development of institutions and governance systems also aspires to contribute to the empowerment of the population and to help individuals and communities take charge of their own future. It also fosters the development of civil society and promotes the formation of the networks and partnerships that are fundamental to processes of economic and social progress (Pike et al. 2009: 19).

Experience has shown that infrastructural investments have not always proven to be successful in delivering on the cohesion goal in lagging regions.[5] It is rather the way investments transform governance (through partnership agreements, programmes and projects) that is relevant. MLG adds a more systematic approach to the Regional Policy of the EU. In his report issued in 2015 upon a request by member of the Commission Johannes Hahn, Luc van den Brande has widely advocated the MLG approach in Regional Policy. Van den Brande states that "MLG helps the EU better communicating EU policies and objectives and their results, as it goes together with multi-layered citizenship" (van den Brande 2014: 9). He emphasizes that it is urgent to abandon the "hierarchical approach in the European Union which places Europe above the Member States, the Member States above the regions, the regions above the cities and the local communities" (ibid.).

Yet he also points the finger at the gaps in the application of MLG, i.e. gaps in information, capacity (human resources), dependence of lower administration levels on the higher levels in fiscal and funding questions, administrative gaps between the functional areas and the administrative units, or policy gaps when only vertical instead of cross-sectoral approaches are being pursued (van den Brande 2014: 10). One of the main reasons is the lack of success of diverse EU strategies. Nowadays, Regional Policy, and hence ESIF, is more closely connected to the European Semester. Cohesion policy can be seen as the main delivery instrument for the EU2020 Strategy, with about 60% of ESIF being earmarked for the Strategy (van den Brande 2014: 21). MLG and associated tools such as macro-regional strategies (MRS, see part 2.6), community-led development (CLLD) and integrated territorial investments (ITI) or joint action plans (JAP), have all so far proven to be less than optimal instruments for advocating and implementing MLG. In the context of our approach, it is relevant that van den Brande states that the administrative capacity on all levels must be raised in order to realise MLG:

> Benchmarking, exchange of experiences and peer learning between regions and cities should be supported by the EU and Member States, also by using EU instruments such as the European Territorial Cooperation programmes. A Public Sector Innovation Platform, aiming at supporting and coordinating public sector innovation, should be established (van den Brande 2014: 22).

[5] Pike et al. write: "The supposedly high returns of infrastructural investment identified by some researchers […] fuelled the belief that improving accessibility was the solution for lagging areas. Development and employment policies were thus articulated around the building of motorways, aqueducts, pipelines, telephone lines and other investments in infrastructure. Such investment has unfortunately not always yielded the expected results" (Pike et al. 2009: 13).

Governance as such specifically matters to regional and local authorities, since the communities are the level where policies come into effect. In this regard, the national layer still bears a significant importance when it comes to making a difference – be it in terms of social equality or competitiveness (Pike et al. 2009: 143). Nevertheless, the territorial or place-based approach is essential in making a region competitive. Van den Brande states: “It is my conviction that Member States can only attain tangible results on the ground in translating the CSF into a meaningful PA when they take due account of the specific situation within their territory” (van den Brande 2014: 11). In the same line of thought, Pike, Rodriguez-Pose and Tomaney argue that national governments are still highly important for regional development, despite an ever more international and globalised economy, multi-level governance and new supranational forms of government/governance such as the European Union. In the future, MLG will be essential in making EU cohesion policy a success, as it leads also to more decentralised forms of empowerment (van den Brande 2014: 6). Nevertheless, national governments keep the capacity to tax and thereby greatly affect regional development (Pike et al. 2009: 151–2). Moreover, it is not only the Regional Policy schemes that a national government follows, but everything a government does that at the end of the day affects regional development (Pike et al. 2009: 127).

Traditional development policies	*Local and regional development*
1 Top-down approach in which decisions about the areas where intervention is needed are taken in the national centre	1 Promotion of development in all territories with the initiative often coming from below
2 Managed by the national central administration	2 Decentralised, vertical cooperation between different tiers of government and horizontal cooperation between public and private bodies
3 Sectoral approach to development	3 Territorial approach to development (locality, *milieu*)
4 Development of large industrial projects, that will foster other economic activity	4 Use of the development potential of each area, in order to stimulate a progressive adjustment of the local economic system to the changing economic environment
5 Financial support, incentives and subsidies as the main factor of attraction of economic activity	5 Provision of key conditions for the development of economic activity

Figure 2: Local and regional development (Pike et al. 2009)

1.3. Conclusions for Southeast Europe

Even a cursory look into current theoretical literature in the field of economic development and economic history is sufficient to understand that the role of institutions has been widely underestimated. New institutional economics can shed light especially on the situation in Southeast Europe/the Danube Region, as it draws attention to the embeddedness of an economy into a society and highlights the importance of incentives. Already in the early 90s, North addressed the issue that "[s]ocialist economies are just beginning to appreciate that the underlying institutional framework is the source of their […] poor performance and are attempting to grapple with ways to restructure the institutional framework to redirect incentives that in turn will direct organizations along productivity-increasing paths" (North 2009: 110). Moreover, Coase, in his address when receiving the Nobel Prize in 1991, two years before North, stated:

> The value of including […] institutional factors in the corpus of mainstream economics is made clear by recent events in Eastern Europe. These ex-communist countries are advised to move to a market economy, and their leaders wish to do so, but without the appropriate institutions no market economy of any significance is possible. If we knew more about our own economy, we would be in a better position to advise them (Coase 1992: 4).

Today, this statement still holds true. But has the role of institutions been paid due respect? Murrell states that "[i]n sum, the NIE was a surprising spectator in the early transition debates" (Murrell 2008: 672). Is it correct to analyse national economies, if we consider that communities are to a certain extent 'imagined' (see Anderson 2006) and that national states, especially small and medium ones like in the Danube Region, are highly exposed to exogenous effects and economic globalisation? Another feature that weakens the role of nation states in current economic development context is multi-level governance. In the complex governance of EU Regional Policy, local and regional authorities have a crucial role to play and possess an intensive relationships with the supranational level. Acemoglu/Robinson have shown that decentralised structures work only if there is institutional thickness and administrative capacity on all levels, interacting on the horizontal one with businesses and civil society, social partners and associations. One might say that Acemoglu/Robinson have focused too much on the national state, while the overall picture especially in the Danube Region but also in the entire EU is much more fragmented: some nations are far from being an 'economy of scale' and entities have often a long history. In this respect, an institutional approach has the advantage of focusing also on the social aspects of economic development and the interaction between a society and markets (Pike et al.

2009: 91). However, on the epistemological level, this could be regarded as social constructivism. Unlike neoclassic theory, which NIE intends to complement, NIE starts from the assumption that markets are not perfect, but that their imperfection is even one of their essential features and that institutions exist in order to cope with such an imperfect information scenario. It analyses the incentives that drive actors to act in one or the other way.

While the upcoming parts of this study will be dedicated more to the technical implementations of ESIF, the relevance of institutional capacity in this context and in the delivery on the goal of territorial, economic and social cohesion, NIE helps us to understand the *longue durée* (cf. also figures 3 and 4 in this regard, where literacy in 1880 and internet access in 2014 show very similar pictures in the Danube Region). This *longue durée* is the reason why North emphasizes the importance of the fact that economic change is incremental and that experiences in the transformation countries as well as in the third world have shown that 'shock therapy' cannot function. While the necessity to restructure institutions has proven to be a major obstacle to change, the process of economic change is not yet fully understood and can be understood only by assessing economic history. Like Barca or Rodríguez-Pose, North clearly refuses a 'one-size-fits-all' approach (North 2008). Nevertheless, the case of Poland shows that institutional rearrangements after ‘shock therapy’ have led to a better use of ESIF and hence to better economic development. With regard to this, it shall also be highlighted that planned economies were far from being underdeveloped:

> The predicament was not simply one of underdevelopment, with poorly working, incomplete market-capitalist institutions. Rather, under central planning, most essential economic activities were governed by powerful institutions that were antithetical to market capitalism. Mammoth institutional destruction and construction was on the agenda; whatever strategy drove that agenda (Murrell 2008: 667).

One has to consider in this respect that at the same time, most of the economies during real existing socialism also triggered considerable grey or shadow economies, that can be to a certain degree be considered as capitalistic, even if they were related to systematic corruption and thereby to the central planning mentioned above (cf. Bafoil 2009).

The upcoming parts of this work shall be based upon the assumption that the post-communist transition in Eastern Europe and NIE are of mutual significance. While NIE is an approach that helps to understand these transformational processes, the institutional changes that these countries have undergone are highly relevant for building the theoretical body of NIE.

Whereas a macro-economic point of view of NIE focuses on institutions as the rule of the game, micro-economic analyses in this theoretic approach deal with the reduction of transaction costs (see Murrell 2008). Every economy provides a mixed set of incentives and opportunities, and it is the institutional framework that "determines the incentive structure of the society" (North 2008: 24). This 'payoff' structure is reflected in the organisations, be it the formal or even informal ones of a society, e.g. in the skills and knowledge. North states that

> If the highest rate of return in an economy comes from piracy, we can expect that the organizations will invest in skills and knowledge that will make them better pirates. Similarly, if there are high returns to productive activities we will expect organizations to devote resources to investing in skills and knowledge that will increase productivity (North 2008: 23).

One of the main questions of this study is how incentives can be established which foster productivity and how an institutional environment can be created through EU policies and investments that is conducive to incentives that allow for inclusive economic and political institutions.

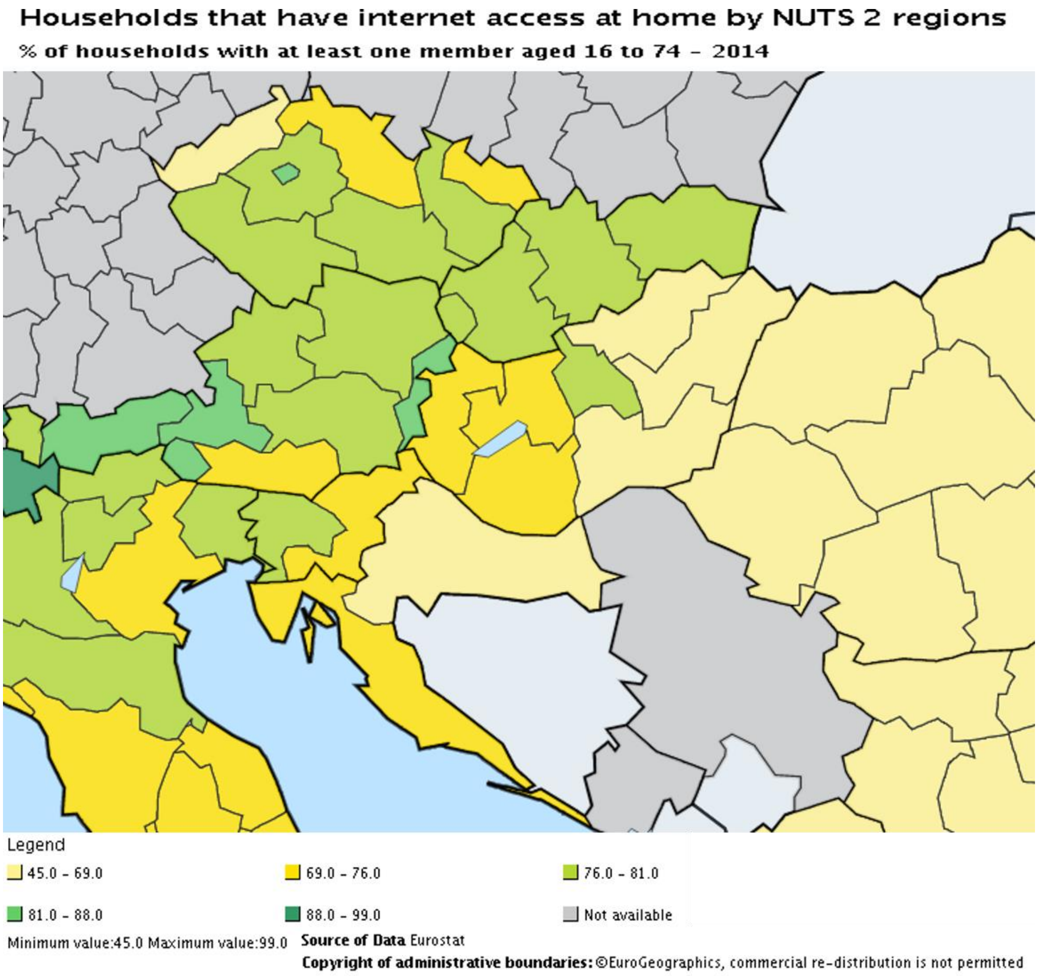


Figure 3 Internet access in 2014 on NUTS2 level, Eurostat data

Figure 4 Literacy in Austria-Hungary in 1880

2. Institutional capacity in the framework of EU Regional Policy

In the light of the previous more theoretical part, this chapter deals with EU Policies (Regional, Enlargement, Neighbourhood) in the Danube Region and intends to have a closer look on the relationship between the institutional and the economic performance of the macro-region. An assessment of the European Bank for Reconstruction and Development (Besley et al. 2010) shows that the role of institutional patterns in the development has been widely underestimated. The report states i.a. that "[f]or many years, mainstream economics largely took for granted the institutions needed for a market economy to flourish" (Besley et al. 2010: 7). However, experience shows that this approach has not worked very well and that the hope that free markets would automatically foster democratic development has turned out to be an illusion. Besley et al. state:

> In this sense, development of state institutions complements market development, in contrast to what was sometimes suggested 20 years ago. Another contrast with the conventional wisdom of 20 years ago is that the endpoint of transition is much less clearly defined now than it was then: there are multiple versions of capitalism, and the historical and institutional contexts of individual countries necessarily affect their destinations. This has been brought into sharp relief during the current financial crisis (Besley et al. 2010: 1).

The report is clearly influenced by the insights of NIE and emphasizes the embeddedness of markets into institutional settings. It also states that there is a "need to rethink the appropriate role of the state". There should be a focus on the "qualitative rather than the quantitative dimension of transition – that is, not just markets, but well-functioning markets; not just regulation, but effective regulation" (Besley et al. 2010: 3). According to the EBRD, there are three main features of a successful market economy:

– the competence/efficiency of producers;
– the balance of interests between producers and wider social goals;
– the institutionalization of solutions to regulatory issues.

The EBRD's experience shows that many of the insights we have gained in the previous parts and especially in the analysis of NIE actually hold true. Projects that were implemented have sustained competitive markets and also limit the opportunity for political influence on private firms. The same applies to transparent public procurement procedures as well as to more federalist forms of governance; the latter may be supported by projects carried out by local or regional governments, with a potential effect of positive intergovernmental competition. Moreover, it is not the least the movement towards EU accession that triggers institutional reform and thereby supports more stable markets, since the EU plays a significant role in competition policy and areas of business regulation (Besley et al. 2010: 11–2). After 20 years of active work in the region, the EBRD's strategy follows mainly two main insights. The first is that a market economy requires an "effective state" and "supporting institutions". For instance, privatisations are only beneficial if there is strong regulation and competition policy, i.e. privatisations must be *legitimate*. The second insight is that there was no "victory of the market", but that it is crucial to build resilient and sustainable markets with a long-term view. For the EBRD, building resilience could also mean focusing more on education and innovation, as well as aspects of social cohesion.

Another conclusion is that in order to foster social cohesion, the EBRD lends also to public projects in order to create a self-sustained market. The opposition here is not public vs. private, but there is a common goal of "market conformity". The impact of transition should i.a. be related to the measurement of its "institutional pre-conditions" (Besley et al. 2010: 21–5). It can be concluded that even if NIE was a “surprising spectator of post-communist transformation”, many of the assumptions it has brought forward regarding the informal and informal institutional configuration of economies have proven to be true.

2.1. Measuring the quality of institutions

The Danube Region is region of major economic disparities, as it hosts both very competitive and wealthy regions such as Baden-Württemberg and also the least developed regions of the entire EU and Europe as a whole. It is the goal of cohesion policy to overcome these disparities through the ESIF, whereas the European neighbourhood and Enlargement Policy intends to prepare the respective countries for EU accession. In the framework of the EUSDR, a socio-economic study was published by Priority Area 8, which deals with competitiveness and SMEs (Centre for European Economic Research GmbH et al. 2014). It states i.a. that one of the most important shortcomings of the “Lower Danube Region” are that the institutional environment for investment and economic development is not sufficient in the Danube Region.

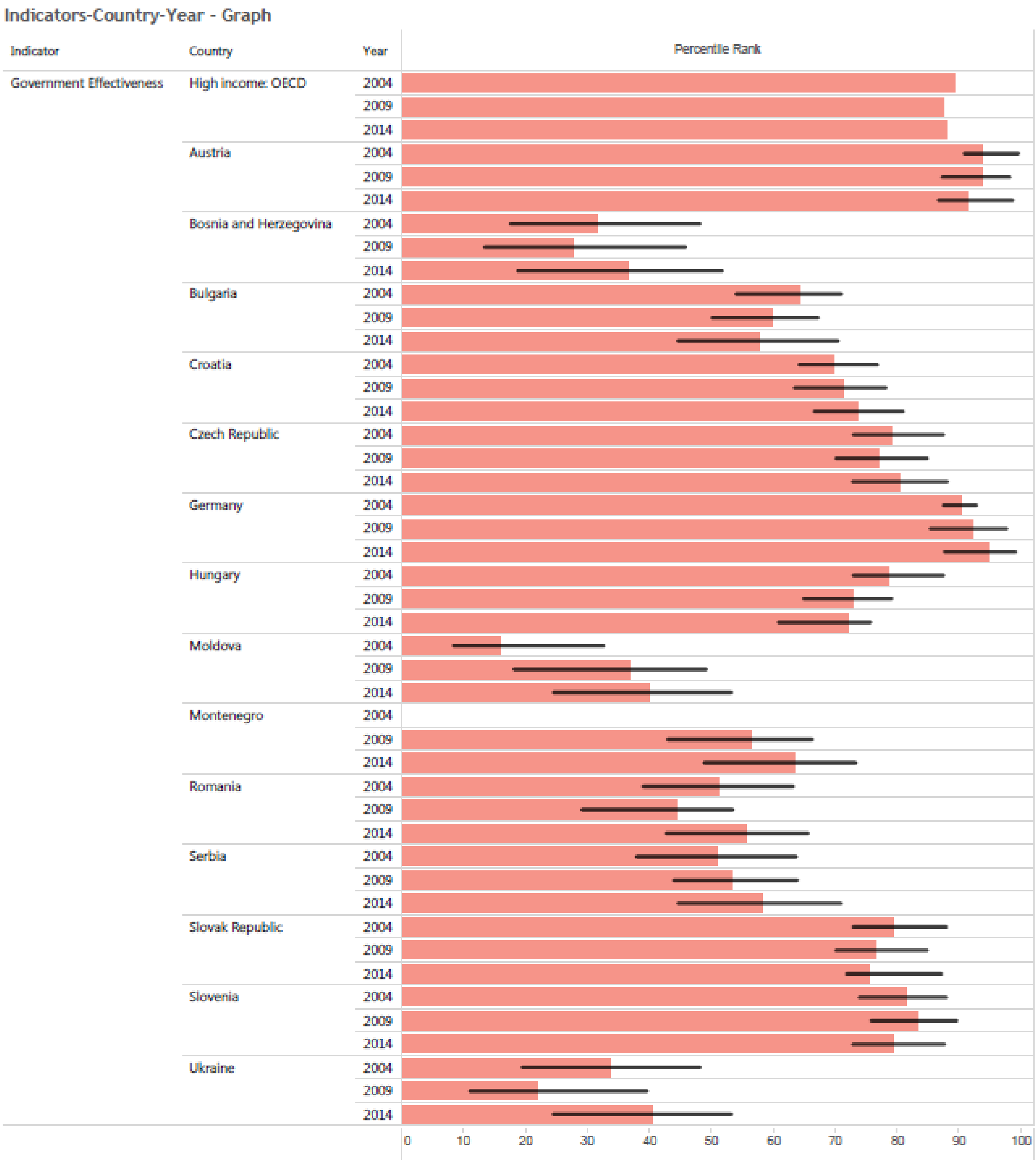
But how to measure the efficiency or quality of institutions? For public administration, at least, several methods have been developed, and data is available, e.g. from the World Bank (and also its “doing business” report), the Bertelsmann foundation, Eurostat or the OECD. Based i.a. upon the World Bank data, the Gothenburg University and its Quality of Government (QoG) Institute have established indicators for measuring the quality of governments, also on the sub-national level, where there are significant disparities in some of the EU Member States (e.g. Spain, Italy or the UK). Disparities in the latter two can be seen as reasons for the establishment of the ERDF. The World Bank’s Worldwide Governance Indicators (WGI) measure the following categories:

- voice and accountability;
- political stability and absence of violence/terrorism;
- governance effectiveness;
- regulatory quality;
- rule of law;
- control of corruption.

With regard to this the question arises how governance is defined. The World Bank draws upon existing notions of governance, and seeks to navigate between overly broad and narrow definitions. It defines governance as *“the traditions and institutions by which authority in a country is exercised"* (Kaufmann et al. 2010: 351). In the framework of this study, which is to be seen in the context of EU Regional Policy, the four last indicators are of particular importance. While the first and the second indicator refer to the process by which governments are selected, monitored, and replaced, the third and the fourth deal with the capacity of governments to effectively formulate and implement sound policies. The fifth and sixth indicators deal with the respect of citizens and the state for the institutions that govern economic and social interactions among them (Kaufmann et al. 2010: 354).

Looking at the indicators, the overall assessment is that the institutional patterns in the Danube Region are improving, but on very disparate levels. For the implementation of the Regional Policy of the EU and territorial cohesion, regulatory quality in particular is of major importance. The indicator of government effectiveness shows for instance that Germany and Austria are above the average of high-income OECD countries, whereas Danube region countries in the European Neighbourhood (MD, UA) show rather low levels in this regard. Among the new EU Member States, only CZ, SI and SK show levels of government effectiveness that are comparable to the OECD high-income threshold. In the context of the financial and economic crisis starting in 2008, it is worthwhile to also examine the development of this indicator from 2004 to 2014: the picture is rather mixed and only DE and MD show a clear trend upwards, whereas many countries in the macro-region such as BG or HU saw a decrease in their institutional capacity. The other indicators demonstrate very similar trends. While the quality of rule of law has generally well progressed in the Danube Region, the regulatory quality does not show the same pattern, which is of particular relevance for the EU cohesion policy.

Figure 5 Government Effectiveness, World Bank



The World Bank data has been discussed and amplified i.a. by the University of Gothenburg and its Quality of Government (QoG) Institute, which has extended the endeavour to the subnational level, especially in the bigger EU Member States (within which there are huge disparities) and has developed the European QoG Index. In their analysis of the World Bank indicators, Charron et al. note that "[f]or example, it is found that the gap between Italy's Bolzano region, which ranks near the top of all EU regions, and Campania, which is among the lowest, is wider than the gap between the countries of Denmark and Hungary, for example" (Charron et al. 2014: 70).

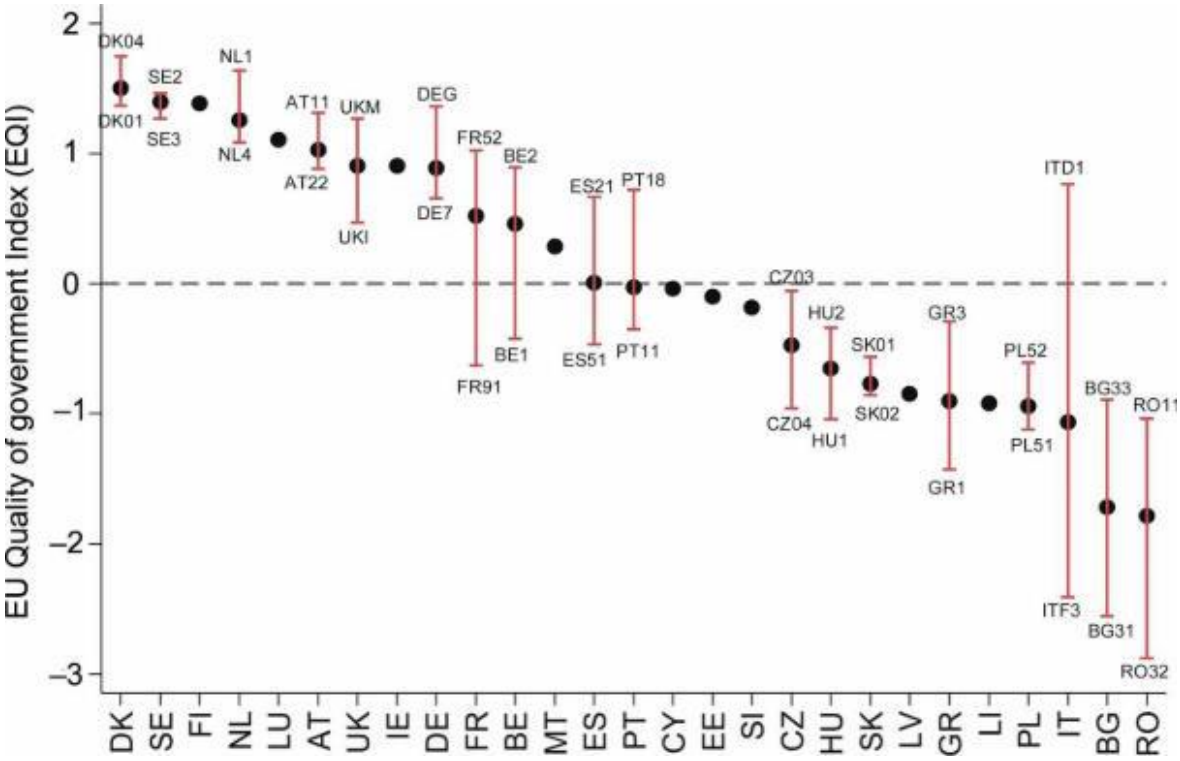


Figure 6 The European QoG Index (EQI) and within-country variation. (Charron et al. 2014, p. 76)

This regional assessment gives us a clearer picture, especially when it comes to the delivery on the goal of economic, territorial and social cohesion in the Danube Region. It is evident at first sight that the QoG indicator above more or less complies with the different levels of GDP in the EU.

Starting from this assessment, Charron et al. develop five hypotheses. First, there is a correlation between the QoG index and socio-economic development. This hypothesis is largely supported by relating QoG to the human development index (HDI). Second, the size of a country or a territory is related to QoG, as medium-sized countries in the EU such as the Nordic ones or the Netherlands perform better than bigger ones such as France or Germany. However, this hypothesis cannot be entirely sustained on a more systematic basis and especially not on the subnational/regional levels. The third hypothesis is that high-trust societies are more likely to score better in the QoG index. This aspect seems to be highly significant for the lower Danube Region. Where trust is higher in social groups such as a clan or a family than in the state, citizens are less keen on improving the QoG. Postsocialist societies in the Danube Region are in general low-trust societies. This hypothesis is clearly confirmed by the authors, who state that they cannot identify a clear causality, but a certain relationship between trust and QoG. The fourth hypothesis brought forward by the authors is that higher decentralization leads to a higher variety in QoG within a nation state and might even lead to forms of unhealthy competition among regions or local authorities. The authors therefore also conclude their fifth hypothesis, which is that the degree of (de-)centralization affects QoG of a country as a whole. However, both hypotheses could not be sustained by the authors (Charron et al. 2014: 76–80). The two hypotheses that could be confirmed, i.e. the relation between wealth and QoG, as well as trust and QoG are of high relevance for the Danube Region, as most countries – with the notable exceptions of Austria and Germany – can be seen as low-trust societies, with GDP levels below the EU average. This is also highly relevant with regard to the aforementioned notion of MLG, as the vertical and horizontal consistency, the 'institutional thickness' is crucial in creating cohesion and requires trust. Moreover, in the light of recent political developments, especially in Hungary and Poland, it seems rather that democratic institutions are a pre-condition for free market and *not* vice versa, which was an assumption that was brought forward by many politicians and researchers in the 1990s. The QoG is of course also of high relevance for the Structural and Cohesion Policy:

QoG rank (European Union)	Country	Combined QoG score	Equivalent non-European Union country
1	Denmark	1.978	Switzerland
2	Sweden	1.915	Switzerland
3	Finland	1.909	Switzerland
4	Netherlands	1.834	New Zealand
5	Luxembourg	1.747	Canada
6	Austria	1.701	Australia
7	United Kingdom	1.628	Singapore
8	Ireland	1.628	Singapore
9	Germany	1.620	Singapore
10	France	1.403	United States
11	Belgium	1.368	Barbados
12	Malta	1.268	Japan
13	Spain	1.103	Chile
14	Portugal	1.084	Chile
15	Cyprus	1.077	St Lucia
16	Estonia	1.043	St Lucia
17	Slovenia	0.994	Israel
18	Czech Republic	0.826	Uruguay
19	Hungary	0.759	South Korea
20	Slovakia	0.651	Botswana
21	Latvia	0.608	Costa Rica
22	Greece	0.574	Cape Verde
23	Lithuania	0.563	Cape Verde
24	Poland	0.552	Qatar
25	Italy	0.480	South Africa
26	Bulgaria	0.101	Panama
27	Romania	0.059	India

Figure 7 Quality of Government Comparison (Charron et al. 2014, p. 71)

> [A] region with a low QoG in the EU is much less likely to use the Cohesion Policy funds in an efficient and effective manner, or to have lower levels of small business entrepreneurship. […] Finding the right mix of incentives and policies that improve QoG in lagging regions could make a substantial contribution to higher growth in those regions and thus to more convergence between EU regions (Charron et al. 2014: 81).

The authors conclude that "apart from the existing transfer policies – a joint and targeted effort to improve QoG in those regions with lower levels could substantially improve the economic prospects of these regions and the lives of their residents" (Charron et al. 2014: 82). This statement must be seen as highly relevant for this study, and the upcoming chapters dealing with thematic objective 11 of the ESIF, which aims at enhancing the quality of institutions mainly in the regions mentioned above and is of particular importance for the southern and new member states in the EU.

If we draw upon the insights gained in part 1.1 dealing with NIE, it is first and foremost the contractual arrangements that determine the institutional patterns of a society, both with regards to the informal and formal institutions. In this regard, the aspect of trust mentioned above exemplifies the importance of the relationship between these formal and informal institutions. This again highlights the relationship between economic development and the large historical lines of political development and social capital. In this respect, it is also worthwhile to consider the cultural values that influence the attitudes and finally the institutional behaviour of economic actors, especially when it comes to informal institutions. The World Value Survey carried out by a network of social scientists (see Figure 8) proves that while most countries in the Danube Region are on similar levels of secular-rational values (compared to traditional ones), the new member states which are also former communist countries are characterised by values that are more related to survival than self-expression. This also affects the general morality, as there is an important distinction to be made between generalised (universal) and limited morality. Such assessments of individual behaviour can clearly be related to economic development:

> Lack of trust and lack of respect for others are typical of hierarchical societies, where the individual is regarded as responding to instinct rather than reason, and where instinct often leads to a myopic or harmful course of action. In such societies, individualism is mistrusted and to be suppressed, because nothing good comes out of it: Good behavior is deemed to result from coercion, not from internalization of the values of society. Hence, the role of the state is to force citizens to behave well. Likewise, the role of parental education is to control the negative instincts of children, often through recourse to violence (Tabellini 2010: 685).

Such hierarchical societies can be seen as non-meritocratic, which is a considerable hindrance in developing not only institutional capacity, but also inclusive institutions as defined by Acemoglu and Robinson (2013). Tabellini builds upon the NIE. He enquires as to how cultural values affect economic growth and states that some indicators such as trust, control, or respect are conducive towards economic development, while some others such as obedience are not. In particular, factors such as literacy (see also Figure 4) and institutions are to be considered when relating culture to economic development. General morality positively affects the functioning of institutions, which in turn has a positive influence on the economy. Distant political history thereby turns out to be an important determinant of economic development. However, it is not only the inertia of formal political institutions, but also the persistence of informal ones that affects development. It is easy to conclude that informal institutions matter more in societies where morality is less generalised (cf. Tabellini 2010).

In this regard, one might state that the market and the informal and formal institutions are mutually dependent and influence each other. It may be worthwhile to confront the insights of NIE with the French philosopher Michel Foucault's discourse theory, which, building upon the school of historians *école des annales*, has considerably contributed to the understanding of the relationship between a discourse, a dispositive and finally institutions. Foucault has notably contributed in this regard to understanding the genesis of neo- and ordoliberal theory (see Foucault et al. 2004).

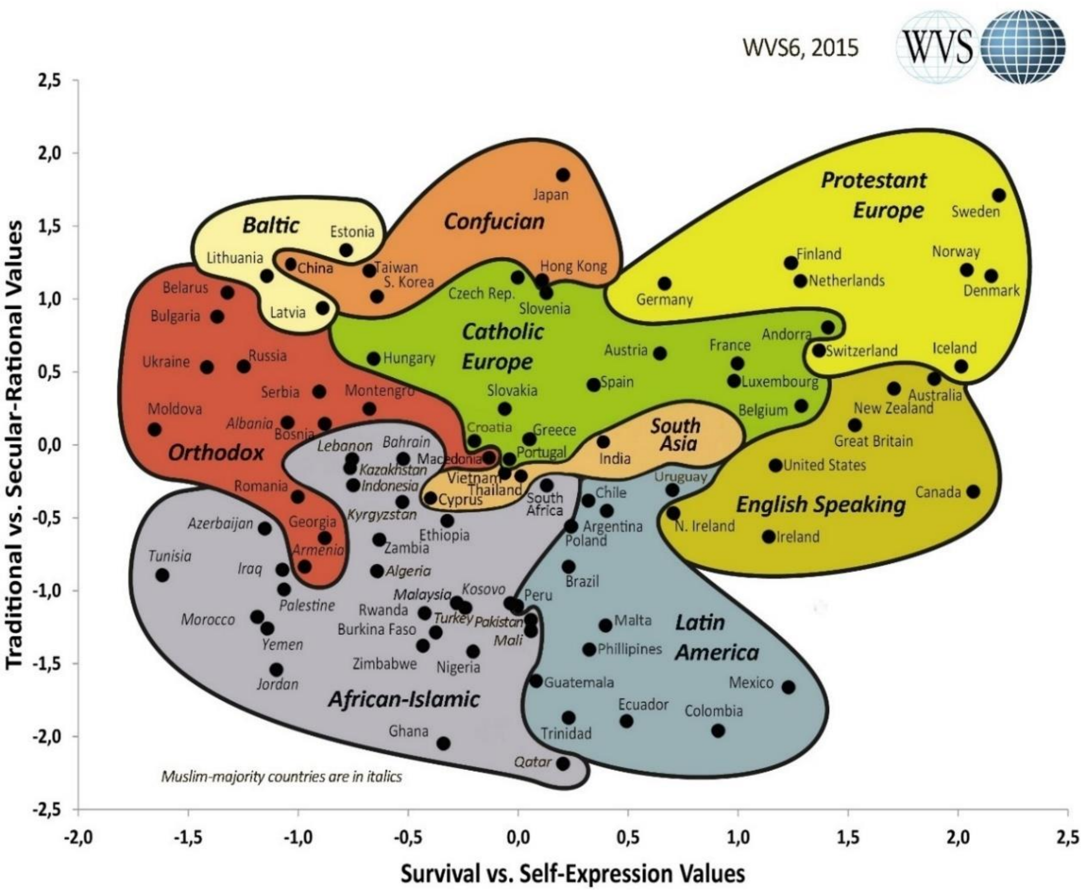


Figure 8 Cultural Map - World Value Survey 2010-2014

NIE has also emphasised the contractual arrangements within institutional patterns and more specifically focused on the transaction costs within institutional configurations. The World Bank has also delivered a "Doing Business" report in the framework of its 'doing business' project starting in 2002. This report measures the quality of regulations in different countries.

The list below gives a brief overview of the main indicators for starting a business in the Danube Region countries.[6] By June 2015, only Bosnia and Herzegovina with 37 days was above the limit of 4 weeks for business start-up permissions. Nevertheless, the average in the Danube Region is approx. two weeks, which is about 5 days more than the average of OECD high-income countries, with around 9 days.

Figure 9 Doing Business Report, World Bank - Danube Region

Country	Rank	Distance to frontier	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in min. capital (% of income per capita)
OECD high income	..	91.24	4.80	9.20	3.40	8.80
EU Danube Region Average	73.5	87.02	6.36	14.64	4.44	15.90
Austria	101	83.42	8.00	22.00	0.30	13.60
Bosnia and Herzegovina	147	72.51	11.00	37.00	14.60	28.60
Bulgaria	49	91.09	4.00	18.00	0.80	0.00
Croatia	88	85.43	7.00	15.00	3.50	26.60
Czech Republic	110	82.58	9.00	19.00	8.00	0.00
Germany	114	81.38	9.00	14.50	8.80	35.80
Hungary	57	90.04	4.00	5.00	8.30	54.00
Moldova	35	92.16	5.00	6.00	4.60	0.00
Montenegro	56	90.05	6.00	10.00	1.60	0.00
Romania	38	91.93	5.00	8.00	2.10	0.70
Serbia	66	88.91	6.00	12.00	6.80	0.00
Slovak Republic	77	87.02	7.00	11.50	1.50	19.20
Slovenia	15	94.39	2.00	6.00	0.00	44.10
Ukraine	76	87.35	6.00	21.00	1.20	0.00

Moreover, since 2004 (first enlargement round), there was a significant trend downwards in terms of procedures and days in each of the Danube countries:

[6] Data relies upon the Doing Business Report of the World Bank, see http://www.doingbusiness.org/data/exploretopics/starting-a-business

Figure 10 Number of procedures to establish a business, Doing Business Report

Country	Year	Procedures (number)	Time (days)
Austria	DB2004	8	25
Austria	DB2015	8	22
Bosnia and Herzegovina	DB2004	12	68
Bosnia and Herzegovina	DB2015	11	37
Bulgaria	DB2004	11	32
Bulgaria	DB2015	4	18
Croatia	DB2004	11	29
Croatia	DB2015	7	15
Czech Republic	DB2004	10	40
Czech Republic	DB2015	9	19
Germany	DB2004	9	45
Germany	DB2015	9	14.5
Hungary	DB2004	6	52
Hungary	DB2015	4	5
Moldova	DB2004	11	42
Moldova	DB2015	5	6
Montenegro[7]	DB2007	13	24
Montenegro	DB2015	6	10
Romania	DB2004	6	29
Romania	DB2015	5	8
Serbia	DB2004	12	56
Serbia	DB2015	6	12
Slovak Republic	DB2004	10	103
Slovak Republic	DB2015	7	11.5
Slovenia	DB2004	9	60
Slovenia	DB2015	2	6
Ukraine	DB2004	15	40
Ukraine	DB2015	6	21

In its thematic fiche for the European Semester related to thematic objective 11 which deals with institutional capacity, the Commission recognises that the "quality of the public administration is important for economic competitiveness and societal well-being." Moreover, for an environment that would be conducive for investment, the following main statistical indicators upon which the Commission's analysis builds are of major importance:

[7] No earlier data available.

- government effectiveness
- administrative modernisation, which is subdivided into e-government, human resource management, and evidence-based policy-making
- administrative burden to start up a company
- the quality, independence and efficiency of the justice system;
- corruption.

The Commission builds widely upon data provided by the World Bank, but also the World Economic Forum, Eurostat, and the EU Justice Scoreboard. The overall assessment is that the countries of the Danube Region perform poorly, and even Germany and Austria are not at the levels of the Nordic countries. Bulgaria and Romania in particular are facing challenges in their general governance and Romania is lagging behind when it comes to modernising administration. Due to high staff rotation, public investment is being constrained, especially in the Czech Republic, Slovakia, Hungary, Poland and Romania. Moreover, there is a lack of strategic human management in many of the countries in Southeast Europe. The high administrative burdens on businesses also jeopardizes economic development. The same is true for judicial independence, which is particularly poor again in Romania, Slovakia and Bulgaria. Corruption and the diversion of public funds affects these countries and in particular the Czech Republic (European Commission 2012: 1–10).

A specific feature of the Danube Region is its comparatively low wages, which makes some parts of the macro-region also competitive in terms of labour costs. A study conducted by DG ECFIN assesses the gap between public and private wages. In times of budgetary constraints, there is a tendency to cut government expenditure. On average, public sector employees in the EU enjoy higher wages than their counterparts in the private sector. The only exception are Nordic countries, France and most Eastern European countries. If it concerns also Nordic countries, it follows that high wages in the public sector are not directly connected to the performance of public administrations, since these administrations perform very well. In the EU, the average public worker is more likely to be female, older, and more highly educated than workers in the private sector. Moreover, public workers have more often permanent contracts. Another significant pattern is that the wage gap in favour of the public sector primarily concerns lower-skilled workers (Castro et al. 2013).

Figure 11 Characteristics of public wages in the Danube Region according to Castro et al. 2013

EU MS	Characteristics
AT	Wage gap in favour of public sector and for older and male workers
BG	Public wages 9.3% lower than in private sector in 2010. Public employees with very high educational levels have a very negative income gap (-39.7 %); older workers are privileged compared to younger ones. Public sector workers within higher professional categories obtain remunerations much lower than in the private sector (i.e. -52.9% for managers).
CZ	Negative wage gap is significant primarily for female and young workers in the public sector. Public managers on higher levels suffer from a significant wage gap (i.e. -45.4 % for managers)
DE	No overall wage gap for public officers. Managers with tertiary education earn less than their counterparty in the private sector.
HU	Public sector wages are significantly lower (-15.8 %) than in the private sector, especially for female workers. The gap is also more significant among highly educated workers.
RO	The overall assessment is that there is a positive wage gap for workers in the public sector. However, there are large negative pay gaps for the highly educated (-44.6%) and especially for women.
SI	Public sector wages are higher than in the private sector. A relatively small gap was observed only in the case of public managers.
SK	A negative wage gap for public sector employees was observed especially for the young and female ones. There is also a significant gap for highly-educated (i.e. -32.3% for professionals and -25.8% for managers). Lower skilled workers in the public sector, especially male one, enjoy a positive gap.

The overall assessment of the eight countries in the Danube Region that were analysed in the study is that the main problem is not the differences between the public and the private sector, but a public sector that systematically disadvantages the following groups of public workers in comparison to the private sector:

- young people
- women;
- highly-skilled employees with tertiary education.

If we consider the fact that the Danube Region faces significant challenges in terms of brain drain and emigration, the above-mentioned pattern has certainly negative effects on the institutional capacity of the administrations in the countries of the Danube Region. If we think back of the previous chapters and state that “[t]he solution to the economic and political failure of nations today is to transform their extractive institutions toward inclusive ones” (Acemoglu and Robinson 2013: 402), the pattern shown above is not a sign that the institutions in the Danube Region are on a path towards inclusive institutions, even if the wages were increased in most of the past few years in the majority of the countries of the Danube Region (see Figure 12, especially in Romania).

Figure 12 Remuneration of national civil servants in central public administration.

Net remuneration in nominal terms / real terms
Nominal value

GEO/TIME	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
European Union (EU6-1972, EU9-1980, EU10-1985, EU12-1994, EU15-2004, EU25-2006, EU27-2013, EU28)	103.1	102.7	104.0	103.1	99.7	101.0	101.1	100.4	102.3	101.3
European Union (aggregate changing according to the context)	102.7	101.9	102.5	103.0	99.4	101.1	101.2	100.1	102.1	101.4
Bulgaria	:	100.0	117.7	100.0	100.0	100.0	100.0	100.6	98.5	101.2
Czech Republic	107.9	105.2	108.5	108.6	98.9	99.9	98.9	104.4	101.7	102.1
Germany (until 1990 former territory of the FRG)	100.4	98.2	102.7	103.1	95.9	101.3	104.3	100.9	100.9	103.0
Croatia	:	:	:	:	:	:	:	100.0	100.0	100.0
Hungary	114.0	103.2	107.6	98.1	107.7	109.4	104.0	99.3	101.5	101.3
Austria	102.0	102.0	102.5	104.7	102.4	99.7	102.0	99.8	101.8	101.7
Romania	:	117.6	118.3	100.0	98.3	103.0	106.3	114.4	106.8	103.8
Slovenia	101.9	106.4	105.6	100.6	101.0	100.7	92.6	102.4	98.0	99.9
Slovakia	105.0	104.7	106.7	107.0	101.1	96.5	100.7	105.0	106.3	100.9

2.1.1. Country-specific recommendations (CSR)

The Commission's recommendations for the CSR in the region give a good overview of the above-mentioned challenges that are at stake in the Danube Region. They are also essential when it comes to planning the ESIF. The table below shows that it was mainly the EU Member States that do not perform very well in general economic terms that also received CSRs in relation to their institutional capacity.

(Sub-)sector CSR	Member State	Number of MS
Improving the effectiveness and efficiency of the public administration	BG, CY, CZ, ES, EL, HR, IT, RO, SK	9
Judiciary reform	BG, EL, ES, HU, LV, MT, RO, SI, SK	9
Improve the business environment	BG, EL, ES, HU, IT, PL, RO	7
Anti-corruption	BG, CZ, EL HR, HU, IT	6
Public procurement	BG, EL, HU, HR	4
Absorption of ESI funds	BG, RO, SK	3

Figure 13: CSR related to TO11 (European Commission 2014a: 5)

The Commission calls for the EU Member States to reflect these recommendations in the operational programmes of the ESIF, which has widely been implemented. Below is an analysis that was carried out with the most important issues related to institutional capacity in the EU-MS in the Danube Region.

Figure 14 CSR in the Danube Region related to institutional capacity

MS	COM (2016)	Recommendation and/or issues addressed related to institutional capacity
AT	340	Recommendation: Reduce administrative and regulatory barriers for investments, such as restrictive authorisation requirements and restrictions on legal form and shareholding, and impediments to setting up interdisciplinary companies, in particular in the area of services.
BG	323 40	Characteristics: Unstable policies and lack of trust in key public institutions Slow implementation of public administration reforms New legislation is not subject to systematic impact assessment Frequent changes to the legal framework create uncertainty and affect the businesses environment. Corruption – this problem continues to be exacerbated by weak and fragmented institutions and has negative effects on the business environment Recommendation: under the Cooperation and Verification Mechanism on judicial reform and the fight against corruption and organised crime, therefore no CSR

CZ	324	Characteristics: Weaknesses in public administration Acts against corruption are delayed Better procurement conducive to competition is needed, including better training for procurement <u>Recommendation</u>: Reduce regulatory and administrative barriers to investment, notably in transport and energy, and increase the availability of e-government services. Adopt the outstanding anti-corruption reforms and improve public procurement practices
DE	326	Characteristics: Weak public investment in infrastructure <u>Recommendations</u>: Reduce inefficiencies in the tax system, in particular by reviewing corporate taxation and the local trade tax, modernise the tax administration and review the regulatory framework for venture capital. Step up measures to stimulate competition in the services sector, in particular in business services and regulated professions.
HR	331	Characteristics: Complexity in the functional distribution between national and local levels; fragmented system Negative effects of fragmented public administration on business environment No progress in public administration reform Complexity of public sector wage system <u>Recommendation</u> 1: By the end of 2016, start reducing fragmentation and improving the functional distribution of competencies in public administration to improve efficiency and reduce territorial disparities in the delivery of public services. In consultation with social partners, harmonise the wage-setting frameworks across the public administration and public services. Reinforce the monitoring of state-owned enterprises' performance and boards' accountability. Advance the listing of shares of state-owned companies and the divestment process of state assets. <u>Recommendation</u> 2: Take measures to improve the quality and efficiency of the judicial system in commercial and administrative courts. Facilitate the resolution of non-performing loans, in particular by improving the tax treatment of the resolution of nonperforming loans.
HU	337	Characteristics: Limited progress in the transparency of public procurement Weak effectiveness of the National Anti-Corruption Programme No protection of whistle-blowers Business affected by volatile regulatory environment and administrative burden Regulatory restrictions for retail sector <u>Recommendation</u>: Strengthen transparency and competition in public procurement through e-procurement, increased publication of tenders and further improvement of the anticorruption framework

RO	343 41	Characteristics: Limited effectiveness and transparency of public sector Delays in adopting a transparent HR approach and foster meritocracy Unstable organisational structures Weak professionalism of civil service Inefficient public procurement system and complicated administrative procedures Weak use of evidence-policy making and consultation processes Weak absorption of EU funds Widespread corruption at all levels of government Lack of rule of law <u>Recommendation</u>: Under the Cooperation and Verification Mechanism on judicial reform and the fight against corruption and organised crime, therefore no CSR
SI	344	Characteristics: Delayed action in anti-corruption measures and in administration modernisation Improvements for the business environment are needed especially with regard to insolvency and liquidation <u>Recommendation</u>: Take measures to modernise public administration and reduce the administrative burden on business. Improve the governance and the performance of state-owned enterprises.
SK	345	Characteristics: Inefficient public administration and lack of coordination Act on civil service not yet adopted Impact of measures against corruption is limited Illicit practices and lack of transparency in public procurement Weak professionalism Lack of evidence-based policy making Legislation volatility and high administrative burden jeopardize business development <u>Recommendation</u>: Consolidate governance, reinforce the shift from price only to quality-based competition and improve the prosecution of illicit practices in public procurement. Improve the transparency, quality and effectiveness of human resources management in public administration, in particular by adopting a new civil service act, and the effectiveness of the justice system. Adopt a comprehensive plan to address administrative and regulatory barriers for businesses.

As mentioned above, Bulgaria and Romania are under the mechanism for cooperation and verification, which was established in line with Commission Decisions C (2006) / 6569 and 6570. The report concerning Bulgaria concludes that Bulgaria took important steps towards reform after a period of relative political instability. However, strategies to fight corruption and implement judicial reform have to be translated into concrete action. The Commission welcomes the constitutional reform, but criticizes the slow progress in the fight against high-level corruption. It recommends i.a. a new anti-corruption law, amendments to the law on public administration and the pursuit of efforts against both high-level corruption and low-level corruption in the Ministry of the Interior, as well as measures against organised crime (European Commission 2016a: 11–3). For Romania, the Commission addresses the many convictions of politicians and the political cataclysms related to it. The Commission confirms progress in a number of areas that are connected to the rule of law. Action should be taken primarily in the field of judicial independence. Moreover, it is stated the EU funds should be used in order to prevent low-level corruption. In addition, i.a. a new public procurement strategy shall be pursued with the aim of combating corruption (European Commission 2016b: 13–4).

2.2. How ESIF affect national & regional governance in the Danube Region

Before we assess how investments in institutional capacity are performed through ESIF, we should have a look on how ESIF transform the institutions of the NMS in the Danube Region and leads to Europeanization of administration (see e.g. Bache 2010). After the process of democratisation after totalitarianism, the process of adopting EU practises was challenging for many countries in the Danube Region, as pluralism was required not only within the parliaments, but in society as a whole. While the administration of a state is a national affair, Regional Policy (not least through shared management) creates significant pressure as regards adaptation of the national administration: the implementation of ESIF also requires compliance with the partnership principle among different layers of governance and with civil society[8], as well as strategic medium-term planning as opposed to ‘short-termism’. Ilona Pálné Kovács points out that the solution to the adaptive pressure from the side of the EU was often the creation of new institutions, often quasi-governmental or non-profit ones, instead of a reform of the old ones (Pálné Kovács 2007: 75–8). She states that

> [W]e can conclude that the EU's Regional Policy has proved a crucial motivation for modernizing national public administration in the sense of regionalism, managerialism, partnership or more flexible governance´. But the new challenges could be answered by functional adaptation as well, and several member states could be successful in the absorption of Structural Funds without dramatic structural changes in public administration. The reason for that may be that Western democracies have had a much more stable (and integrated public sector than the newcomers (Pálné Kovács 2007: 79).

[8] This matters not only with regard to article 11 of the TEU, but is also a principle of the governance of the entire EU, especially in the fields of environment and social policies. (cf. European Commission (2001))

Pálné Kovács asks whether NMS in Eastern and Central Europe are prepared or not for the challenges with European integration, also because they had to adapt their public administrations in a much shorter period of time than the 'old' Member States (Pálné Kovács 2007: 81). In this context, it is important to distinguish between the Central European countries and the states in Southeast Europe. This is only partly due to the wars in the Western Balkans, since Romania and Bulgaria share similar challenges with countries in this region (Dolenec 2013: 10–1).

In order to apply the EU Regional Policy, it was necessary in all former communist states to strengthen the local, regional and municipal tier of governance, especially the NUTS II level.

In the case of Hungary, the system of EU Regional Policy did not lead to a 'federalization' of the state - the opposite is true - and the last years saw clear tendencies for centralization, especially when as concerns the Prime Minister's Office. However, Hungary has seriously adapted its structures to Regional Policy - but this adoption can be considered as rather formal, with the creation of a 'corporate' type of administration.

In the Czech Republic, only limited decentralization could be observed. Regionalization has lost its impetus after accession to the EU. Romania is still in a starting phase of its own restructuring and yet suffers from high degrees of centralization and from political instability. The potential positive impact of Regional Policy is still hampered by the weakness of the structures. The high degree of centralization is also at stake in Slovenia, which is also due to its small size. Similar problems of restructuring can also be observed in Bulgaria.

Pálné Kovács concludes that EU Regional Policy often leads to a fragmentation of the administrative structures of the NMS and at the same time does not foster decentralization, which is a necessary pre-condition for the implementation of ESIF. Public administrations need to be evaluated and higher professionalism is required on all levels of government. Nevertheless, so far, this implementation has led rather to 'institutional chaos' than to institutional 'thickness'. EU Regional Policy, she concludes, must support unconditionally the regional level of the NMS – otherwise, regional integration is not very likely to succeed. (Pálné Kovács 2007: 83–96)

This goes hand in hand with the statement that

> "to date, research has highlighted numerous adjustment problems to the EU cohesion policy framework in CEECs […]. These changes clashed with the pre-existing 'ways of doing things'

> within the public administration and were hampered by the limited learning and adaptation capacity of the domestic institutions involved. This seems to confirm the expectation that, due to the legacies of the past and the nature of the conditionality-driven adjustment to EU requirements precluding socialization mechanisms (Dąbrowski 2013: 1364).

One can conclude that the EU cohesion and enlargement policies have intensified the interaction among actors (also in terms of MLG) and also changed the nature of interdependencies. Nevertheless, despite these changes and a respective transition to new forms of governance, no sustainable transformation was created as “national governments can generally be effective gatekeepers over the levers of power and influence in the domestic arena” (Bache 2010: 121).

2.3. Thematic objective 11 “Institutional Capacity” (TO11)

2.3.1. Institutional Capacity in the EU Legislation

This legal background defines how this thematic objective can be transformed into an investment priority (IP) of an operational programme (OP). The current legislative framework for ESIF foresees thematic concentration in accordance with article 18 of the common provisions regulation (henceforth to be referred to as ‘CPR’, 1303/2013):

> Member States shall concentrate support, in accordance with the Fund-specific rules, on interventions that bring the greatest added value in relation to the Union strategy for smart, sustainable and inclusive growth taking into account the key territorial challenges of the various types of territories in line with the CSF, the challenges identified in the National Reform Programmes, where appropriate, and relevant country-specific recommendations under Article 121(2) TFEU and the relevant Council recommendations adopted under Article 148(4) TFEU. Provisions on thematic concentration under the Fund-specific rules shall not apply to technical assistance (European Commission 2015c: 73).

These priorities are defined in article 9 of the CPR. When setting up a programme, thematic priorities (chosen within the newly introduced thematic concentration) translate into investment priorities in accordance with the country-specific recommendations (CSR, see part 0.1.1) and the partnership agreements between the EU Member States and the European Commission. The money is spent accordingly and projects are implemented that correspond to these thematic priorities. In our present context, it is first and foremost the so-called thematic objective 11 “enhancing institutional capacity of public authorities and stakeholders and efficient public administration” (TO11) that is of major importance. However, it needs to be borne in mind that all the thematic objectives to a certain extent contribute to enhancing institutional capacity, as one may argue that, through the management methods that come with EU project and fund management, a significant number of actors are being ‘Europeanised’.

TO11 can be found in the following ESIF regulations:

Figure 15 TO11 in ESIF regulations

Reg. n°	Fund	Provision related to TO11 (according to European Commission 2014a)
1303/2013	all	Article 9 (11) – “enhancing institutional capacity of public authorities and stakeholders and efficient public administration” Related provisions:

		ANNEX XI, Ex-ante conditionalities, (11) “enhancing institutional capacity of public authorities and stakeholders and efficient public administration”
1304/2013	ESF	Article 3 – Scope of support (d) (i) "Investment in institutional capacity and in the efficiency of public administrations and public services at the national, regional and local levels with a view to reforms, better regulation and good governance"; (d) (ii) "Capacity building for all stakeholders delivering education, lifelong learning, training and employment and social policies, including through sectoral and territorial pacts to mobilise for reform at the national, regional and local levels".
1301/2013	ERDF	Article 3 – Scope of support from the ERDF (11) "Enhancing institutional capacity of public authorities and stakeholders and efficient public administration through actions to strengthen the institutional capacity and the efficiency of public administrations and public services related to the implementation of the ERDF, and in support of actions under the ESF to strengthen the institutional capacity and the efficiency of public administration" Article – 5 Investment priorities 11 (f) "Networking, cooperation and exchange of experience between competent regional, local, urban and other public authorities, economic and social partners and relevant bodies representing civil society, referred to in Article 5(1) of Regulation (EU) No 1303/2013, studies, preparatory actions and capacity-building".
1299/2013	ERDF/ETC	Article 7 – Investment priorities (a) "under cross-border cooperation (iv) enhancing institutional capacity of public authorities and stakeholders and an efficient public administration by promoting legal and administrative cooperation and cooperation between citizens and institutions); (b) under transnational cooperation: enhancing institutional capacity of public authorities and stakeholders and an efficient public administration by developing and coordinating macro-regional and sea-basin strategies)".

In its thematic guidance fiche for the TO11, the EC states that the quality of public administration has a "direct impact on the economic environment", a link that was highlighted in almost every political document. ESIF – i.e. in the case of TO11 only the

ERDF and the ESF – shall implement TO11 in line with the country-specific recommendations (CSR) in the framework of the European Semester. Moreover, internal papers and positions of the EC and the experience from the past MFF shall be taken into consideration. The EC points out that institutional capacity reaches far beyond the mere technical training of public officers, as it supports the principles of good governance and social capital. TO11 focuses not only on national administrations, but also local and regional ones. The ultimate goal should be a 'strategic and result-oriented' approach that triggers the reform of administrations. (European Commission 2014a)

For the Commission, there are three dimensions for interventions in the field of enhancing institutional capacity. Firstly, structures and processes, secondly, human resources and thirdly, service delivery.

- As for the structures and process, the Commission points out that traditional bureaucracies are oriented towards public sector services. However, modern organisations in the public sector establish more responsive forms including team work. New structures highly reflect upon their own efficiency and foster regulatory changes, a highly relevant aspect also for cohesion policy. The Commission obviously aims at a public sector that is efficient, open in terms of MLG and civil society, and respects the European principles enshrined in the Treaties, such as transparency and civil society participation (art. 11 TEU) or proportionality (art. 5 TEU) and subsidiarity (art. 3 TEU).
- For human resources, the Commission proposes i.a. capacity building programmes, modernisation of recruitment procedures, as well as new training methods.
- The field of service delivery mainly addresses the optimisation of business processes, e-government, benchmarking etc.

TO11 is first and foremost relevant for the ESF and the European Territorial Cooperation goal (ETC) of the ERDF. In order to reach stable and predictable institutions, the investment aims at the modernisation of administrations in those Member States that have at least one less-developed region and therefore are eligible for cohesion fund assistance. This rule does not apply to the ERDF. Through the application of TO11, stakeholders such as NGOs can also be supported out of the ESF. While the ESF covers actions such as reform of legislation, efficiency of public service, stakeholder capacity or social pacts, the ERDF mainly can support these ESF actions, especially in the field of provision of infrastructure and/ or equipment. Another considerable pattern is the ETC related to administrative capacity (although transnational cooperation can be funded out of the ESF (art. 10, regulation 1304/2013) (European Commission 2014a: 5–8).

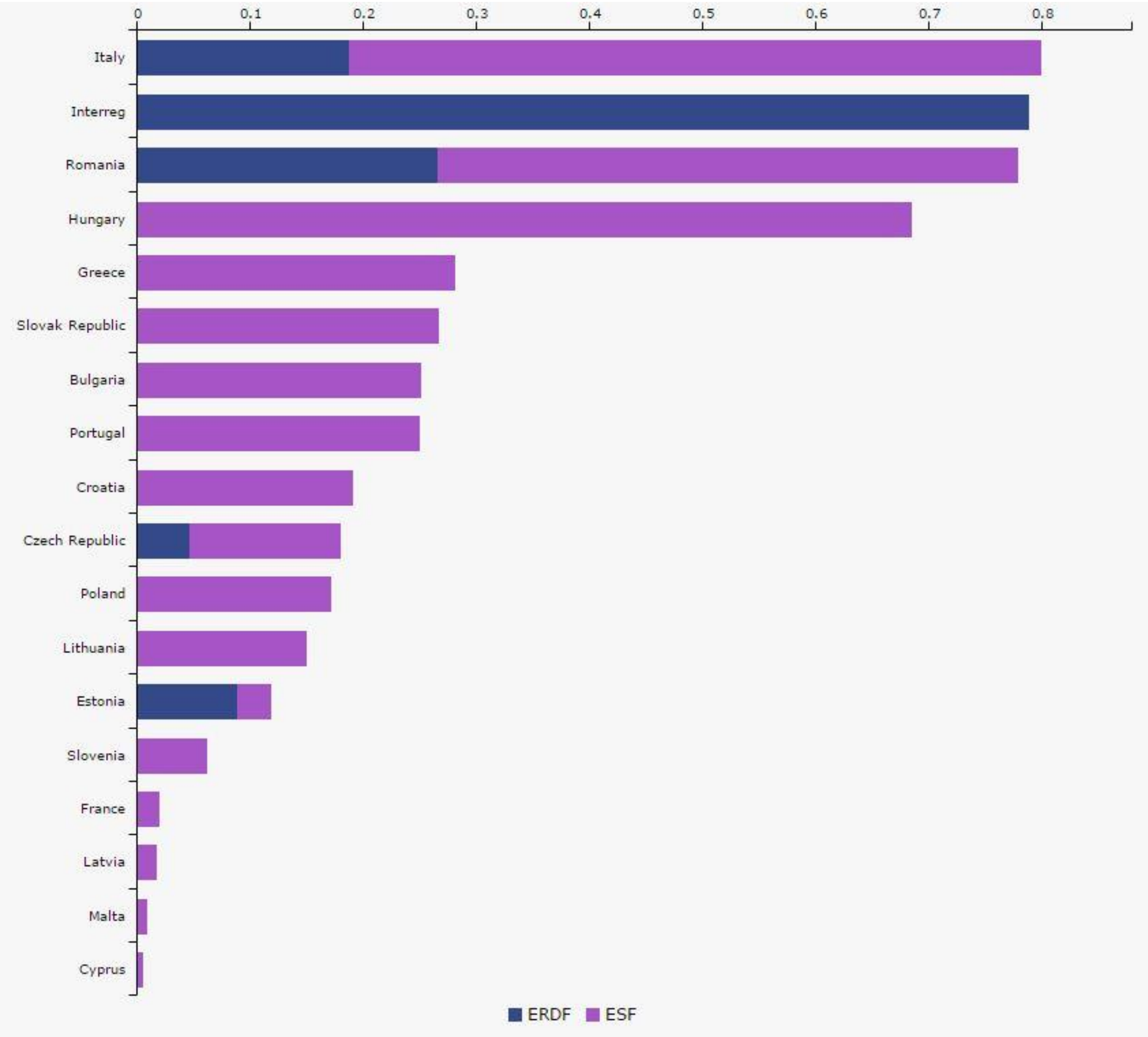
TO11 includes primarily 'soft' investment, even under the ERDF. TO11 under the ERDF means that those actions are supported that are related primarily to the use of the ERDF. Another distinction to be made is that between TO11 and Technical Assistance. While Technical Assistance helps the authorities to implement ESIF programmes and is directly related to them, it does not support any 'political' endeavour with regard to public administration reform. TO11 pursues long-term goals in relation to the EU2020 Strategy, Technical Assistance sustains ESIF in their delivery. Moreover, other TOs such as TO8 (employment), TO9 (social inclusion) or TO10 (education) share similar characteristics with TO11 and may support action with relevance for administrative reform. Cross-sectoral issues, e.g. judiciary reform, clearly fall under TO11. The other TOs (1 to 7) are mainly relevant for the ERDF and not for the ESF. Typical aspects for TO11 are measures in the fields of e-government, public procurement, anti-corruption, or to improve the business environment.

Moreover, TO11 supports stakeholders through the ESF (e.g. NGOs that want to contribute to policy making) as well as the reduction of the administrative burden. A specific feature is the European Territorial Cooperation goal (ERDF) and the transnational cooperation through the ESF, especially in the fields of the exchange of data, judicial cooperation or the support of macro-regional strategies. While in the ESF there is no dedicated transnational cooperation, the ERDF provides transnational, interregional and cross-border programmes dedicated to a specific territory (European Commission 2014a: 9–12).

2.3.2. Mainstream funds (ESF, ERDF)

In accordance with the CSR and legislative framework mentioned above, the EU is investing considerably into building institutional capacity. In the current multiannual financial framework (MFF) €6.4 billion (€1.4 billion of national contributions) is foreseen to be invested into TO11, be it through the ESF or the ERDF.

Figure 16 TO11 in the EU (€ billion), graph by DG REGIO



It becomes clear that – in accordance with the legal provisions – TO11 matters first and foremost for EU Member States with weak levels of cohesion and is applicable only in those countries that are also eligible for the cohesion fund. Moreover, within the ERDF it is primarily relevant for interregional cooperation.

TO11 is of particular importance for the Danube Region. For example, in Romania, a specific Operational Programme was set up for administrative capacity (worth €658 million), in Bulgaria for Good Governance (€258 million) and in Slovakia for effective public administration (€335 million). Moreover, within territorial cooperation, most of the cross-border and transnational programmes have chosen the same priority of institutional capacity:

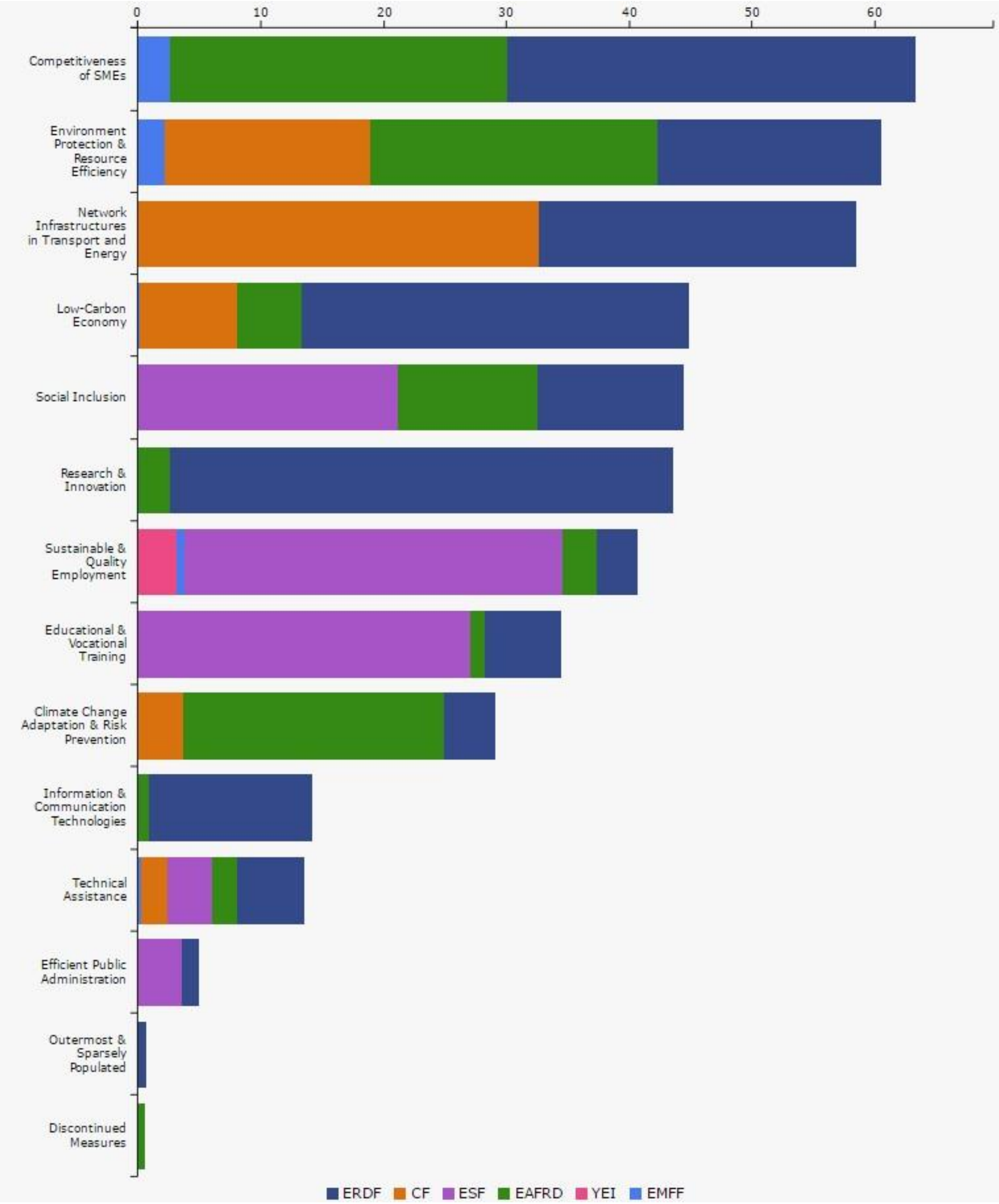
Figure 17 Programmes in the Danube Region considering TO11

State	Fund	Programme considering TO11	Total Budget	Solely TO11
BG	ESF	Good Governance	336 million	Yes
	ESF	Human Resources Development	1.1 billion	No
CZ	ERDF	Integrated Regional Operational Programme (IROP)	5.4 billion	No
	ESF YEI	Employment	2.6 billion	No
HR	ESF YEI	Efficient Human Resources	1.8 billion	No
HU	ERDF ESF	Central Hungary	927 million	No
RO	ESF	Administrative Capacity	658 million	Yes
SI	ERDF ESF CF YEI	Implementation of the EU Cohesion Policy	3.8 billion	No
SK	ESF	Effective Public Administration	335 million	Yes

In addition to the EU investment of €5 billion for TO11, €10.6 billion is to be invested for technical assistance in the current budget period. 72.6% of the TO11 funding is to be spent through the ESF and 27.4 via the ERDF. The relevance of TO11 for the interregional cooperation provides the topic of institutional capacity with a specific international, and thereby strategic dimension. In addition to this, it is evident that the EU Member States have considered the CSR as related to institutional capacity.

Nevertheless, the figure below shows that TO11 (i.e. 'efficient public administration') was not considered to the same extent as other TOs. These TOs might however be more cost-intense than TO11 (such as investments in infrastructure). They might also trigger the efficiency of institutional capacity, e.g. through investments in education. Moreover, the project and programme management that comes with ESIF leads to a Europeanization of actors that are involved. Only four out of eleven TOs are financed out of the ESF, and with the ESF alone, TO11 would have a more prominent role. It also matters in our context that the ESIF are of particular importance in the New Member States in the Danube Region, as they represent the most important source of public investments, whereas in the 'old' member States national and regional subsidies prevail.

Figure 18 Investments through ESIF according to different TOs, current MFF (2014-2020), in € billion



2.3.3. <u>ETC of the ERDF</u>

For the European Territorial Cooperation goal of the ERDF, TO11 detains a very important role. In total, €10.1 billion is spent on the INTERREG out of the ERDF in the current budget period, which amounts to 2.75 % of the cohesion policy. 107 programmes are being set up within three specific strands, dedicated to cross-border (INTERREG A), transnational

(INTERREG B) and interregional (INTERREG C) programmes. Whereas the latter cover the entire EU, transnational programmes cover major strategic areas and cross-border areas on the borders of States. INTERREG A and B programmes also include (potential) candidate countries and countries of the European Neighbourhood through the Instrument for Pre-Accession Assistance (IPA) and the European Neighbourhood Instrument (ENI). Interregional cooperation should aim to "reinforce the effectiveness of cohesion policy by encouraging exchange of experience between regions on thematic objectives" (European Commission 2015c: 392) and it is clear that TO11 as cross-sectoral objective has a crucial role to play in this endeavour.

2.3.3.1. INTERREG A

Within the Danube Region and its multiple borders, there are a number of programmes in the field of cross-border cooperation, some of which also consider TO11. The size of these programmes is approximately between €50 and €200 million. It is clear that the Danube Region has a significant number of borders and that therefore cross-border cooperation is of particular importance. In addition, building institutional capacity is clearly related to the exchange of experience and the transferral of good practices.

Figure 19 INTERREG-A programmes in the Danube Region considering TO11

Programme considering TO11	Fund	Priority	Amount in €
INTERREG V-A - Austria-Czech Republic	ERDF	4	24 million
INTERREG V-A - Slovakia-Austria	ERDF	4	16.7 million
INTERREG V-A - Austria–Germany/Bavaria	ERDF	3	17.9 million
INTERREG V-A - Hungary-Croatia	ERDF	3	6.7 million
INTERREG V-A - Germany/Bavaria-Czech Republic	ERDF	4	32.7 million
INTERREG V-A - Austria-Hungary	ERDF	4	22.4 million
INTERREG V-A - Slovakia-Hungary	ERDF	PA4	25.7 million
INTERREG V-A - Germany/Saxony-Czech Republic	ERDF	4	42.7 million
INTERREG V-A - Romania-Bulgaria	ERDF	PA 5	12.7 million
INTERREG V-A - DE-AT-CH-Liechtenstein	ERDF	3	11.6 million
INTERREG V-A - Slovenia-Croatia	ERDF	3	5.9 million
INTERREG V-A - Slovakia-Czech Republic	ERDF	3	11.7 million
INTERREG V-A - Romania-Hungary	ERDF	PA6	4 million
INTERREG V-A - Slovenia-Hungary	ERDF	2	3.9 million
INTERREG V-A - Slovenia-Austria	ERDF	A.3	14.6 million

2.3.3.2. INTERREG B

INTERREG B programmes focus on the transnational element of territorial cooperation and usually consider TO11, even if the focus is often to cover also social policies within TO11. In the Danube Region, article 7 b) of the ETC regulation (1299/2013) allows for transnational programmes to provide support to macro-regional strategies. In the case of the Danube Transnational programme, the entire programme was designed according to the needs of the macro-region, and will additionally support the Strategy's governance through a dedicated Strategy Point, technical assistance for stakeholders of the Strategy, and a facility in order to support small-scale projects. The adaption of the Danube Transnational programme towards the EUSDR (see part 2.6) created the necessity to establish a new transnational programme called "Balkan-Mediterranean", since the predecessor of the Danube Transnational Programme ('Southeast Europe') also included these areas. Another transnational programme that is highly relevant for the Danube Region is the Central Europe Programme, which has not considered TO11 but also contributes to institutional capacity.

Figure 20 INTERREG-B programmes in the Danube Region considering TO11

Programme considering TO11	Fund	Priority	Amount in €
Mediterranean	ERDF	4	21.1 million
Adriatic-Ionian	ERDF	PA 4	9.8 million
Balkan-Mediterranean	ERDF	2	5.6 million
Danube	ERDF	4	30.9 million
Alpine Space	ERDF	4	11 million

2.3.3.3. INTERREG C

INTERREG C programmes cover the entire European Union and either support other programmes (INTERACT) or sustain regional (ESPON) and urban (URBACT) policies. Therefore, they were set up solely out of TO11. INTERACT also deals with CBC Programmes which combine the ERDF, the IPA, and the ENI and thereby contributes also to enlargement and neighbourhood policy.

Figure 21 INTERREG-C programmes implementing TO11

Programme considering TO11	Fund	Priority	Amount in €
INTERACT	ERDF	1	43.1 million
URBACT	ERDF	1	88.2 million
ESPON	ERDF	P1	45.8 million

2.3.4. Task Force for better Implementation

While the specific setting of operational programmes complies with the needs set out in the recommendations by the Commission for the CSR mentioned above, DG Regio has taken action and introduced a number of new instruments in late 2014 in order to increase the absorption rate and also the efficiency of spending of EU funds (also of the last period), aiming at building institutional capacity and reform, especially in South East Europe and Italy:

1) The **TAIEX peer-to-peer** instrument will be financed out of the ERDF and the Cohesion fund and allows for study visits, workshops, and expert missions (see also part 2.4.4).
2) A **pilot project called "**Integrity Pacts - Civil Control Mechanism for Safeguarding EU Funds Against Fraud and Corruption**" was launched.**
3) A **Task Force for Better Implementation** was created by the Commission for eight Member States that face specific problems in implementing Cohesion Policy (BG, HR, CZ, HU, IT, SK, SI, RO).
4) For the implementation of ESIF, the Commission provides **training** for authorities in charge of the managing, auditing and certifying.

2.4. Institutional Capacity in EU Enlargement and Neighbourhood Policy

Within the enlargement and neighbourhood policies, institutional capacity plays a crucial role, as countries must be prepared to be able to cope with the requirements of the European Union. Public Administration Reform (PAR) is essential within the process of EU enlargement, where institutional reform and rule of law are not only necessary for functioning states, but also for functioning markets, as was also advocated by the EU Enlargement Strategy (European Commission 2015b). The review of the Neighbourhood Policy also puts an emphasis on building institutions and on trust in them, in order to foster good governance and democratic rules, with an incentive-based approach ("more for more") of investment (European Commission and High Representative of the Union for Foreign Affairs and Security Policy 2015).

If we consider that many of the NMS that have suffered real existing socialism show very low levels of trust of their populations in their respective governments, we also have to note that cohesion policy as a policy of transfer and investment policy is a matter of trust among Member States. Sociologist Jan Delhey argues that the recent enlargements towards Eastern Europe have deteriorated trust among Member States, and qualifies Eastern enlargement as "centrifugal expansions" in terms of social cohesion. It is via institutions that Eastern Europe is being 'westernized'. On the other hand, within the Commission, there were diverging interests between DG Enlargement and DG REGIO (Delhey 2007: 273–4).

2.4.1. Instrument for Pre-Accession Assistance (IPA)

The IPA II regulation (231/2014) which was adopted in 2014 provides in article 2 (a) for "support for political reforms, inter alia through: (i) strengthening of democracy and its institutions, including an independent and efficient judiciary, and of the rule of law, including its implementation" (European Commission 2014d: 4). Moreover, article 3.1 (a) defines as one of the IPA policy priorities "reforms in preparation for Union membership and related institution- and capacity-building" (European Commission 2014d: 5). This includes e.g. measures for transparency and accountability in Bosnia & Herzegovina, for the professionalization of civil servants in Montenegro or for public procurement in Serbia.

In the period 2014-2017, a total of 11.5 billion is to be invested through IPA. Democracy and governance, as well as stepping up institutional capacity, are priorities in all three IPA countries in the Danube Region, Bosnia & Herzegovina, Montenegro, and Serbia.

Figure 22 IPA programmes in the Danube Region considering institutional capacity

Country	Fund	Investment Priority	Amount in €
BA	IPA	Democracy and governance	31 million
		Rule of law and fundamental rights	33 million
ME	IPA	Democracy and governance	46.9 million
		Rule of law and fundamental rights	52.3 million
RS	IPA	Democracy and governance	278 million
		Rule of law and fundamental rights	265 million

2.4.2. European Neighbourhood Instrument (ENI)

The ENI regulation (232/2014) puts institutional capacity at the heart of EU activities. This is set out in article 2 where the priorities of the EU are set down. They include i.a. "promoting […] the rule of law, […] establishing deep and sustainable democracy, promoting good governance, fighting corruption, strengthening institutional capacity at all level" (European Commission 2014e: 4).

For the Republic of Moldova, there is an urgent need to restructure its public administration. In the period between 2014-2020, an amount of between €610 million and €746 million is to be spent out of the ENI, 30% of which is dedicated to public administration reform and 15% to capacity development and institution building (European Commission 2014c: 6).

For Ukraine, the picture seems less clear, but approximately €1 billion is to be invested through the ENI. In all Neighbourhood countries, the investments are based upon incentives and the final amount therefore related to the countries capacity for reform.

2.4.3. Interregional Cooperation

Several INTERREG A and B programmes combine ERDF funds with IPA or ENI. There are also IPA Cross-border programmes, but very few in the Danube Region support the enhancement of institutional capacity. For instance, there is an OP based in Budapest combining ENI with ERDF money for the cooperation between Hungary, Slovakia, Ukraine and Romania, which also supports institutional cooperation.

2.4.4. Technical Assistance and Information Exchange instrument (TAIEX)

TAIEX supports activities that support the exchange of information, e.g. through study visits, workshops, or expert missions. Thereby it aims at increasing the capacities of civil servants, representatives of social partners, judiciary or law enforcement units, etc.

2.5. Critical discussion

It has to be noted – and this is one of the starting points of this study – that the ESIF and/or any form of foreign state aid are subject to wide criticism. For instance, Acemoglu/Robinson state in a very general manner that

> [F]oreign aid is not a very effective means of dealing with the failure of nations around the world today. Far from it. Countries need inclusive economic and political institutions to break out the cycle of poverty. [...] Second, since the development of inclusive economic and political institutions is key, using the existing flows of foreign aid at least in part to facilitate such development [...] (Acemoglu and Robinson 2013: 454).

There is a consistent gap between the investment priorities of the EU, the targets of the EU2020 Strategy and other EU strategies. Many authors, but also actors and commentators, highlight the failures of EU Regional Policy. For instance, there is constant criticism of overly high investment in infrastructure, which does not help firms in lagging regions. Moreover, there is the observation that place-based approaches are not being implemented; standardised policies are being replicated regardless of the "local economic, social, political and institutional conditions and by using top-down approaches only" (Pike et al. 2009: 15–6). The idea that the high investment in infrastructure is not what is primarily needed in the Danube Region is widely shared by different kinds of stakeholders, among them representatives of academia, policy makers in fields such as education or employment policies (which are in turn the most relevant ones for four out of five reaching the EU2020 headline targets[9] and also the SEE2020 Strategy), and not least, representatives of business, in particular SMEs.

There are typically four counterarguments: firstly, it is argued that investments in infrastructure also sustain employment and training and thereby affect the entire economy. Secondly, such investments are being seen as a pre-condition for economic development. Thirdly, there are considerable doubts about how to consistently measure 'soft' investments in people and their skills and hence to justify such expenses - 'hard' investments are more easily quantifiable. The fourth argument addresses the very meaning of cohesion. While investments especially in the major cities in the Danube Region would more easily trigger

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[9] There are 5 targets: 1. Employment: 75% of the 20-64 year-olds to be employed; 2. R&D / innovation: 3% of the EU's GDP (public and private combined) to be invested in R&D/innovation; 3. Climate change / energy greenhouse gas emissions 20% (or even 30%, if the conditions are right) lower than 1990; 20% of energy from renewables, 20% increase in energy efficiency; 4. Education: Reducing school drop-out rates below 10%; at least 40% of 30-34–year-olds completing third level education; 5. Poverty / social exclusion: at least 20 million fewer people in or at risk of poverty and social exclusion.

GDP growth, they would jeopardize territorial cohesion and not help lagging and/or remote regions to catch up with the economic centres. Territorial cohesion in Eastern Europe is also strongly related to social cohesion, as poverty – unlike in Western Europe – is mainly concentrated in rural and remote areas (European Commission 2014b: 70).

2.5.1. Evaluation of cohesion policy

The question how to evaluate the effects of cohesion policy is a wide debate. The fact that despite the focus of enlargement and neighbourhood policies on administrative reform and fostering institutional capacity, there are significant shortcomings in the NMS in Southeast Europe indicates that either these policies are not efficient or cohesion policy must invest more into institutional capacity in order to ensure its own implementation.

The low absorption of the last budget period (see Figure 24) and the above-mentioned shortcomings raise the issue of how to evaluate cohesion policy. Ex-ante and mid-term and ex-post evaluations are carried out for OPs. In this regard, Armstrong and Wells distinguish three main philosophical approaches towards evaluation: the positivist, the realist and the constructivist approach. The positivist approach is the most commonly used and focuses primarily on data in order to assess the results of ESIF on an objective basis, be this quantitative or qualitative. This widely accepted approach was challenged by the realist and constructivist ones. The realist approach focuses mainly on the actors of Structural and Cohesion Policy and thereby intends to 'dig deeper' by seeking particularities and peculiarities of actions. Opposed to the positivist approach, it avoids mono-causal explanations of input and output and favours a theory at the heart of which is the behaviour of actors engaged in Regional Policy. This means that the interactions within a social and organizational process are more important than 'hard' economic outcomes. The third approach, constructivism, is a more fundamental challenge to positivism. It assumes that every reality is constructed and that theory is first and foremost a way of simplifying reality. While it could potentially be a contribution to evaluate the long-term effects of investments and programmes, the authors question whether constructivism can ever play a significant role in the evaluation of Structural Funds. They state that the necessity of capacity building was being widely used as excuse for the lack of delivery of ESIF on economic indicators, e.g. job creation. They recommend that more long-term evaluation methods should be applied (Armstrong and Wells 2006: 263–8).

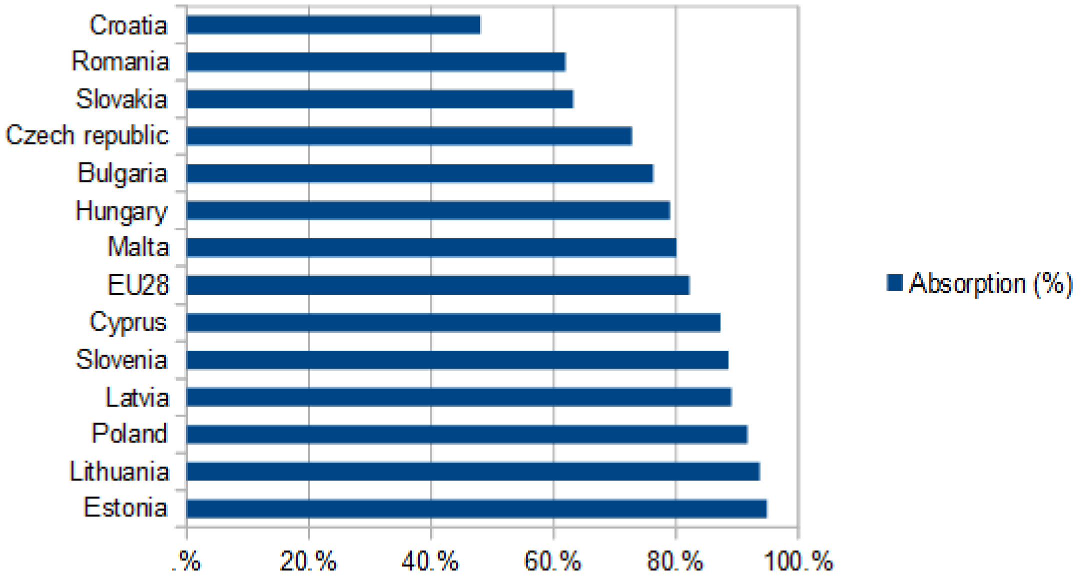
However, in the Danube Region, institutional capacity is so low that ESIF are not even being spent, i.e. the challenges come even beforehand, as the pre-conditions for sound investments are not met. Some authors bring forward the notion of ‘misfit’ (Bache 2010: 116–7) or ‘worlds of compliance’ (Falkner et al. 2007) of NMS which structurally do not comply with the requirements of cohesion policy and where therefore Europeanization is being hampered. While the positive economic effect of structural and cohesion policy is still disputed (Wostner and Šlander Wostner 2009) the more political aspect of Europeanization of its actors sometimes remains rather superficial. Even the experience from Poland – a country that often serves as model for the states in Southeast Europe when it comes to ESIF absorption – shows that Europeanization is multifaceted and actors respond differently to it. Sometimes actors only comply on a superficial basis with the rules brought by EU cohesion policy; sometimes financial and administrative capacity are missing - which is why the impact of cohesion policy remains uneven (Dąbrowski 2013: 1374). In this context, Europeanization can be understood as

> [T]he influence of European-level public policies on the domestic policies, institutions and politics of the member states, the outcome of which depends on the way the European policy framework is institutionalized and interpreted according to embedded domestic institutional arrangements and the actors’ preferences. In the context of the implementation of EU cohesion policy in Central and Eastern European Countries, Europeanization can also be considered as a positive external shock for the established domestic structures, triggering administrative restructuring and construction of institutional capacities, at both national and sub-national levels of government (Dąbrowski 2013: 1367).

Yet, from an NIE viewpoint, change is incremental (North 2009; Bache 2010) and not a shock, even if the ‘shock therapy’ in Poland proved to be successful. Moreover, with regard to the investment prioritization, it can be stated that to a certain extent, the EU investments put the cart before the horse, as “political institutions determine economic institutions and, through these, the economic incentives and the scope for economic growth” (Acemoglu and Robinson 2013: 91). North argued in a comparable manner that weak property rights and high entry barriers as well as weak rule of law will make only trade, redistributive businesses, or the black market profitable. With regard to the aspect of Europeanization through structural and cohesion policy, as well as recent political aspects in Poland (the country which received the biggest amount of subsidies out of ESIF) it is also worthwhile to assess the citizens' opinions about Regional Policy of the EU. A corresponding study was carried out by the Commission. It states i.a. that respondents prefer investments into 'soft' projects (education, SMEs, health) (European Commission 2015a: 51). Only slightly more than a third of EU citizens know about EU Regional Policy, a number unchanged since 2010. EU-financed projects are known by 76% of the population in Poland and only 9% in the United Kingdom (European Commission 2015a: 5).

The analysis of the application of TO11 in the ESIF has shown that in terms of quantity, the ESF programmes in Bulgaria, Romania and Slovakia matter the most and the structural and cohesion policy of the EU will also show in these areas whether it can deliver on the goal of

Figure 23 ESIF Absorption in the NMS for the period 2006-2013, June 2015, data provided by DG REGIO



territorial, social and economic cohesion or not. The ESF needs to be more output-oriented in the ongoing budget period and has also to cope with the effects of the financial and economic crisis, together with the Youth Employment Initiative (YEI) and the new programme for Employment and Social Innovation (EaSI), as well as other initiatives. With the stronger result-orientation, the "[c]ohesion policy is changing dramatically from a mere solidarity instrument to an investment policy" (Nyikos and Talaga 2015: 112). In the field of the above-mentioned TO11, the ESF tackles the following challenges of public administrations in the EU:

– delivering "more with less", i.e. meeting societal/ business needs in times of tighter budgets;

– adapting service provision to the needs of an "online society";

– improving the business environment by cutting red tape and providing better services to business and citizens (Hauser et al. 2014: 10).

The ESF will have the twofold task to improve the administrations for the citizens but also to implement of structural and cohesion policy. The low absorption rate in the NMS in the Danube Region as well as the 're-introduction' of a new variant of the TAIEX instrument for EU Member States reveals to a certain extent that the institutional pre-conditions are not yet met. The approach of stepping up institutional capacity through a Europeanization of actors via projects and programmes could only happen if these projects come to life and involve a multitude of actors on different levels. However, it is not only the lack of capacity of the actors in the NMS that leads to low absorption, but also the complexity of programmes. The result-orientation in the current period might strengthen the effects of cohesion policy, but in terms of institutional development also leads to a stronger centralization in countries where decentralization is needed:

> The demand of the uniform standards and effective management of the new cohesion policy seems to push the structure rather towards centralization instead of decentralization. However, the decentralized planning and implementation could be an effective solution because of the knowledge of local circumstances and characteristics, but of course strong methodological guidance and coordination by central level is required (Nyikos and Talaga 2015: 139).

This approach complies exactly with the historical observation in Acemoglu and Robinson 2013 (see also Figure 1). Nevertheless, despite all the disputes[10], a realist approach (mentioned above, as opposed to a positivist one) still proposes the Europeanization of the actors of EU Regional Policy. Bachtler and Wren define this as "Community 'added value'." They state that it can be argued that "the regulatory obligations, combined with the role of the Commission in promoting 'good practice' in evaluation, have encouraged a greater commitment to, and use of, evaluation for the effective management of programmes" (Bachtler and Wren 2006: 145). The realist approach could also lead to the following question: if we consider the role of the European Union as 'soft' but normative geopolitical power (cf. Manners 2002), that promotes sustainable development or e.g. gender equality, why should this role not be considered for its internal (and external) development policies?

[10] E.g. et al. argue that the optimal transfer intensity of a region on NUTS3 level is between 0.4% and 1.3% of GDP, a level above which EU transfers could simply be abandoned. However, in the last budget period, 18% of the regions received more than 1.3% of their initial GDP. The authors argue that in order to foster cohesion, in the last two programming periods, it would have been more efficient to transfer the investments above this threshold of 1.3% to other regions that are below it. Nevertheless, the confirm –in principle – the economic effectiveness of cohesion policy (Becker et al. (2012)).

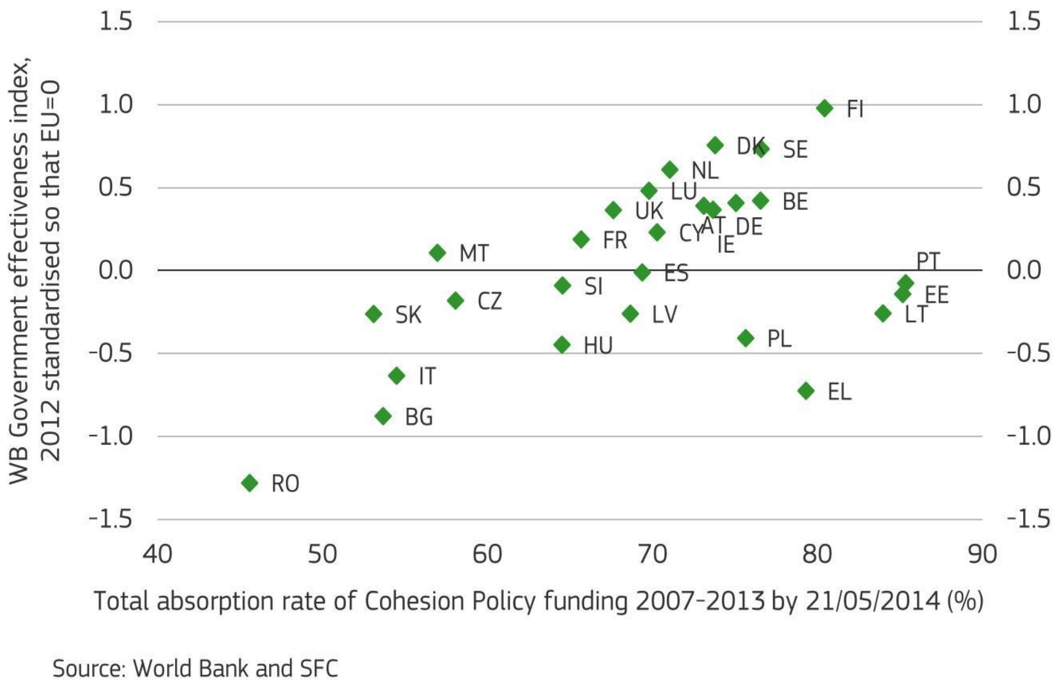


Figure 24: Absorption of Cohesion Policy funding and Government effectiveness, 2014 (European Commission 2014b: 175)

2.6. Macro-regional cooperation as new institutional pathway in the Danube Region

An interesting aspect of the Regional Policy in the Danube Region is the EU Strategy for the Danube Region (EUSDR), a so-called 'macro-regional' Strategy (MRS), which follows the example of the EU Strategy for the Baltic Sea Region (EUSBSR). The Strategy was proposed by the Commission (European Commission 2010) and adopted by the Council (Council of the European Union 2011). Many aspects of this study are derived from the author's experiences in the implementation of Priority Area 9 "People and Skills" (Austrian Ministries for Education) and Priority Area 10 "Institutional Capacity and Cooperation" (City of Vienna). The Balkan wars have left the Danube Region with many small states, which makes regional cooperation a necessity in order to reach an economy of scale (cf. Altmann 2003). The macro-regional approach stems from the necessity to cooperate within a so-called- functional region (in this case the Danube) and thereby is a unique approach that combines regional policies with other policies, e.g. enlargement, social or environmental policies. Moreover, the concept of MRS contains the important capacity to link the policy level with the political one, and also the administrative level with civil society. There is also the hope that the EUSDR could unite the manifold political initiatives (such as the RCC or the CEI) in the Western Balkans under a common umbrella. One could state in this respect that "stakeholders regarded macro-regional frameworks to offer opportunities to achieve their institutions goals, e.g., administrative institutions can simultaneously gain political support and reflect on implementation practicalities" (Sielker 2015: 93).

Although the EUSDR functions very differently from the EU regional policies, as it does not foresee any new legislation, institutions, or funds, it might be a considerable contribution especially to the ETC goal of the ERDF, which partially supports the Strategies out of INTERREG-B programmes. In this regard, one might recall that informal institutions are also to be considered when assessing the institutional framework of a country or an initiative (after all, if informal institutions hamper regional development, why should they not also foster it?).

However, the success of MRS remains rather limited to date. The initial phase of the EUSDR, which was characterized by many motivated stakeholders, was followed by discussions on the added-value of MRS (European Commission 2013; Council of the European Union 2013) and subsequently many questions arose concerning the internal governance of MRS (European Commission 2014f; Council of the European Union 2014).

There is an ongoing discussion on how INTERREG-B programmes can support MRS under article 7 b) of ETC regulation 1299/2013. There is also a strong tendency from various sides to establish a specific kind of 'second ETC' with duplications of structures in those regions where MRS were established. However, the real strength of MRS is that they intend to use *existing* legislation as well as existing funds and institutions, and thereby create strategic projects and foster a discourse that has good chances to enhance regional integration - and hence also the institutional capacity of a region. While the EUSBSR is in reality mainly driven by Sweden, the EUSDR receives its most important incentives from Germany (Baden-Württemberg) and Austria.

Lately, MRS and their added value are increasingly being discussed and there are tendencies to strengthen their impact through a result-oriented approach, similar to ESIF programmes. Moreover, the two 'new' MRS the Strategy for the Adriatic and Ionian region (EUSAIR) and the Strategy for Alpine Region (EUSALP) include to a far lesser degree 'soft' Priority Areas dealing with social policies or capacity building than the EUSDR and EUSBSR did. It is true that MRS require a more precise definition and also have to deliver on their targets. There is also a need to ensure the mutual support of MRS and ESIF, but also the ongoing relations with other policy areas than Regional Policy , especially when it comes to the external dimension of EU Policies, as well as neighbourhood and enlargement policies (European Parliament 2015: 84).

But are MRS the right framework to foster social, economic, and territorial cohesion in the Danube Region, a macro-region with very disparate levels of economic development? At the very beginning of European integration, there was not only the will to cooperate, but also an emerging supranational legislation, new institutions and funding (at least the ESF from 1957 onwards), all of which elements are entirely absent from MRS. However, these elements have also obviously failed both in deepening integration and in fostering cohesion in the NMS in Southeast Europe. The reasons why this endeavour has failed so far are the same ones for which MRS are currently being criticized. Therefore, it can be concluded that soft instruments are probably very appropriate ones when it comes to deepening integration, as they are also able to capture the informal patterns of institutions, which after all also was important for European integration in Western Europe (cf. Pálné Kovács 2007). In this regard, MRS "de facto […] contribute to translate the general European policy objectives into a specific territorial framework" (Roggeri 2015: 3).

There are several reforms required in order to make MRS successful. Firstly, a clarification of responsibilities and tasks is needed in order to make the Strategies successful, since their 'soft' character has created a significant extent of chaos in the implementation. Secondly, there is a need for clarification of the concept of what MRS really means. Thirdly, the MRS concept needs to be embedded in all of the line ministries of the participating countries in order to strengthen not only the bottom-up process, but also the top-down capacity of the MRS. Fourthly, there needs to be a common understanding that the Strategies are long-term endeavours and not a mere duplication of existing programmes and related project activities. Fifthly, MRS might lead to a forum that provides room for criticism about the existing Regional Policy of the EU. MRS challenge existing administration structures, which is also one reason why they sometimes face resistance, be it on the supranational, the national or the programme level (cf. Interact 2015).

A recent study of the EP on territorial governance recommends that territorial governance should be driven by needs and should foster diversity. A new culture in the public sector, that would be more result-oriented, would ultimately lead to a more entrepreneurial attitude and thereby be more innovative - which would require motivated individuals. Territorial governance shall be advocated and administrative capacity be ensured (Böhme et al. 2015: 11). If they succeed in contributing to the institutional 'thickness' of Regional Policy, MRS are certainly an appropriate tool to enhance the territorial governance of the EU.

However, in order to be successful, MRS need to be more operational. They have already succeeded greatly in communicating Regional Policy to the citizens in a very short period of time. However, it is telling that twice as many people over 55 (28%) have heard of the EUSDR than people between 15 and 24 (14%) (European Commission 2015a: 80–2). Therefore, in addition to projects with clear macro-regional impact, projects that strengthen the macro-regional identity, e.g. in the field of education of young people, might be a considerable contribution in making the Strategy a success (Roggeri 2015: 9). In this regard, the continuation of seed money facilities supporting small projects, especially in the (potential) candidate countries and countries of the European Neighbourhood, would trigger substantial added value.

3. Conclusions and outlook

The initial approach of this study was related to the question how institutions affect the objective of social, economic and territorial cohesion in the Danube Region, a so-called macro-region with nine EU-MS (AT, BG, CZ, DE, HR, HU, RO, SI, SK), two candidate countries (ME, RS), one potential candidate (BA) and two countries of the European Neighbourhood (MD, UA).

Despite this very heterogeneous area to be analysed, there is a coherent pattern which indicates that economic success (and hence cohesion) is related to the performance of institutions, as they provide the appropriate environment for sound investments, reduce transaction costs and ensure a functioning relationship between the market and the society that creates trust. The regulatory quality has positive effects on regional integration (cf. ESPON 2016). By putting the insights of New Institutional Economics (NIE) at the heart of this study, it was shown that this relationship is first and foremost a matter of *incentives*, on how people receive a motivation to act, which is the case only if formal and informal institutions are *inclusive*. Moreover, the analysis of institution is also a matter of their history, as "[p]ath dependence means that history matters. We cannot understand today's choices (and define them in the modelling of economic performance) without tracing the incremental evolution of institutions" (North 2009: 100).

The analysis of institutional capacity in the Danube Region has shown that especially the New Member States face significant challenges in stepping up their institutional capacity. The EU accession of several countries in 2004, 2007, and 2013 has not led to necessary reforms and many countries – despite indicators that are generally improving – still suffer from weak administration, a low level of the rule of law, poor conditions for investment, and high levels of corruption. While transition can be seen primarily as "part of a wider process of dynamic institutional development in which economies develop a balance between state and market that enhances the well-being of citizens" (Besley et al. 2010: 5), the advent of European Structural and Investment Funds (ESIF) has not led to a Europeanization of institutions and actors, nor has it led to the de-centralization necessary for the implementation of Regional Policy. However, direct investment into institutional capacity remains relatively weak and investments into large infrastructure projects privileged, whether this be because their results are easier to measure or because the administrative costs for the project implementation are lower.

This leads to the following preliminary conclusions for the Danube Region:

1. There is a need for opportunities for small-scale funding for preparatory action for the implementation of projects or for very small projects. If a state does not provide legal frameworks conducive to economic activities, only big companies will be able to cope with an environment that is basically not business-friendly. Moreover, small-scale funding is needed in order to provide incentives for a real civil society and active citizenship. In addition to this, more informal instruments are needed. For instance, the Erasmus programme is a relatively small programme, but nobody would doubt that it has greatly contributed to European integration. On the other hands, many doubts arise when it comes to this capacity of Regional Policy.
   Sources for innovative funding should be further explored, e.g. there are still very few activities in the field of crowd funding in Eastern Europe. The diaspora could play a significant role in this regard, as high shares of GDP in many countries come from remittances. Microcredits can also play a major role (cf. Nyikos 2015). Moreover, the potential of the e-economy and e-governance is not yet explored in Southeast Europe, unlike in the New Member States in the North, e.g. in Estonia.
2. When it comes to investment into institutional capacity, there could be an explicit – not exclusive – approach on young and/or female public officers or actors, as they are underprivileged compared to the older male ones. Such incentives could greatly enhance both the inclusiveness of institutions in the Danube Region and also foster their Europeanization. Moreover, as the macro-region suffers greatly from the emigration of young and highly-skilled people, programmes could be designed to provide incentives for well-educated people to return to their home countries, as is the case for academic programmes combating brain drain.
3. Related to this, the place-based approach (cf. Barca 2009) needs to be considered in the Danube Region, i.e. that instruments and investments are related to the real needs in a region, also in terms of their quantity.
4. If multi-level governance (MLG) is a pre-condition for the sound implementation of cohesion policy, there is a need for decentralization in most of the new Member States in the Danube Region. In a growingly interdependent and globalised environment, partnerships and cooperation play an increasingly important role, be it between the different layers of EU governance, or between state and civil society actors, MLG matters also in the global context, in order to make the EU a flexible

and reactive actor on the economic and political level. Anchoring MLG in the ESIF regulations is a courageous endeavour and may help to further strengthen European integration and bring strategies such as EU2020 on the ground (van den Brande 2014: 29). However, decentralization should not jeopardize the efficient governance of a state and not lead to its fragmentation. European integration is not only related to economic advantages, but also a matter of political will.

5. There is a need for change in the mentality of actors in the field of Regional Policy. This concerns not only actors in the new Member States, where sometimes the incentives for pro-active attitudes (and hence entrepreneurial spirit) are missing. This also concerns actors from the old Member States and on the supranational level, where new approaches are required in order to cope with the challenges from the last three enlargement rounds. For instance, macro-regional strategies can serve as laboratories for new approaches for both funding and governance. When triggering change, it shall be borne in mind that change is incremental. While short-termism should be avoided – especially in strategies – result-orientation and evidence-based policy making must be ensured.

There is a need to raise the awareness of the economic importance of institutional capacity and its impact of path dependency, i.e. institutional capacity as a pre-condition for economic and social development. More research is needed and innovative approaches that combine approaches in the humanities (e.g. discourse theory) with the economic analysis of institutions, in order to further explore the path dependence towards deepening European integration in the Danube Region. In this respect, it shall be considered that the academic discourse also affects what is being done on the political or policy level and thereby is conducive to change, even if it is only through its mere performativity. In addition to this, as the European Union is a global actor whose internal market affects the global economy, the role of Regional Policy (for investment) as well as the macro-regional approach (for innovative governance structures) could be explored more intensively.

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