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COMMUNICATION FROM THE COMMISSION

Sixth report on economic, social and territorial cohesion: Investing in Europe's Future

{COM(2014) 473 final}

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Chapter 5:
The importance of good governance for economic and social development

1. WHY SHOULD THE EU FOCUS ON GOOD GOVERNANCE?

There are two opposing views among economists of the link between good governance and economic and social development. The first sees good governance as a by-product of development. The second regards s good governance and efficient institutions as a necessary condition for strong economic and social development. It considers that countries can remain stuck in a low-growth, low-quality institutional equilibrium and that a shock may be needed to move them out of it (Acemoglu 2012[1]).

A growing body of research endorses the second view and emphasises the beneficial effect that efficient institutions can have not only on economic growth but also on innovation and entrepreneurship, health, well-being and the reduction of poverty as well as on the impact of Cohesion Policy (Rothstein 2011, Rodriguez-Pose 2012, OECD 2013[2]). As a result, it is now widely accepted that '*high-quality, reliable public services and legal certainty (are) a major precondition for economic success*' and that '... *weak administrative and judicial capacity as well as legal uncertainty constitute key impediments in addressing economic development challenges*.'[3]

One of the major aims of the process involved in accession to the EU is to ensure that the rule of law, equality before the law and non-discrimination are firmly entrenched in the legal framework and practices of the countries applying for entry. These conditions for membership continue to apply after accession and all governments are expected to make sure that they do so.

At a time when Member States are facing increasing pressures on public budgets, the challenge of ensuring high-quality public services requires technological and organizational innovation to boost efficiency. This applies both to delivering public services and designing and implementing high quality public investments.

Good governance, legal certainty and high quality regulations are essential for a stable business environment. The institutions that govern economic and social interactions within a country need to fulfil a number of key criteria. These include the absence of corruption, a workable approach to competition and procurement policy, an effective legal environment, and an independent and efficient judicial system. Moreover, strengthening institutional and administrative capacity, reducing the administrative

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[1] Acemoglu D and Robinson J., 2012, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty,* Random House LLC, 2012, ISBN 0307719235, 9780307719232.

[2] Rothstein B., 2011, *The Quality of Government: Corruption, Social Trust, and Inequality in International Perspective*, University of Chicago Press, ISBN 0226729575, 978022672957

Rodriguez-Pose, A. and E. Garcilazo 2013, *Quality of Government and the Returns of Investment: Examining the Impact of Cohesion Expenditure in European Regions*, OECD Regional Development Working Papers, No. 2013/12, OECD Publishing.

[3] European Commission, SEC(2010) 1272.

burden and improving the quality of legislation underpins structural adjustments and fosters economic growth and employment[4].

The modernisation of public administration was one of the five policy priorities identified in the Annual Growth Survey in 2012, 2013 and 2014[5] since it is seen as a key requirement for the success of the Europe 2020 agenda. The reform of public procurement, digitisation of public administration, reduction of the administrative burden falling on individuals and SMEs and increased transparency are regarded as part of such modernisation[6]. Emphasis is also given to the fight against corruption and improving both public authorities and the judiciary.

This chapter provides an overview of the performance of public institutions in general focussing on the ease of doing business, corruption and governance at the national and regional level and concludes by highlighting the link between good governance and the implementation of Cohesion Policy.

Box on definitions of Good governance

There are a number of different ways of defining and identifying good governance. A relatively straightforward one focusses on the ease of doing business. This is the case of the World Bank's Doing business reports, which argue that governments can facilitate economic growth by providing a simple and transparent regulatory system, so that businesses can concentrate on their core activities and need only to devote a fraction of their resources to complying with administrative procedures.

Transparency International, on the other hand, focusses primarily on corruption, which is defined as the abuse of entrusted power for private gain. Corruption, it is argued, hurts anyone who depends on the integrity of people in authority and goes well beyond limiting economic development to damaging health, trust and well-being.

A more targeted approach is adopted by Bo Rothstein (2011), who argues that good governance means the impartial exercise of public power. This focuses on how policies are implemented rather than on their substance as such and clearly means that there is no place for corruption, ‘clientelism’, favouritism, discrimination and nepotism. The benefit of such a focussed approach is that it facilitates monitoring and targets interventions on ensuring that public institutions operate impartially.

A broader approach is taken by the Worldwide Governance Indicators, also published by the World Bank, which defines governance as "*the traditions and institutions by which authority in a country is exercised. This includes (a) the process by which governments are selected, monitored and replaced; (b) the capacity of the government to effectively formulate and implement sound policies; and (c) the respect of citizens and the state for the institutions that govern economic and social interactions among them*"[7].

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4 The World Economic Forum's Global Competitiveness report has "quality of institutions" as the first pillar of assessment.

5 The 2013 Annual Growth Survey and the Economic Adjustment Programmes highlighted the link and stressed the need for Member States to increase the efficiency and effectiveness of public services as well as the transparency and quality of public administration and the judiciary.

6 Communication COM(2013) 453 final “End-to-end e-procurement to modernize public administration”.

7 The Worldwide Governance Indicators: Methodology and Analytical Issues. Daniel Kaufmann, Brookings Institution Aart Kraay and Massimo Mastruzzi, World Bank

A new European regional indicator combines the approaches of Rothstein, Transparency International and the World Bank, taking account of regional survey results that capture people's experience of corruption and the impartiality of public services as well as national level Governance indicators

Although the differences in definition are salient, the results generated by the different measures are highly correlated which indicates that they all tend to capture the same deficiencies in governance.

2. DOING BUSINESS IS EASIER IN THE NORTH OF THE EU

Good business regulation allows companies to focus their time and energy on doing business without losing time on complying with red tape. The best countries to do business in are not the ones without rules and regulations but those where these are clear and easy to comply with.

The World Bank's "Doing Business" indicator is based on the notion that regulations should be 'S.M.A.R.T' - Streamlined, Meaningful, Adaptable, Relevant and Transparent. The indicator combines 10 aspects[8] to assess the way that business regulations affect SMEs in 189 counties and essentially measures their complexity and the costs they impose as well as the strength of legal institutions.

According to the indicator, Denmark is rated as the most 'business-friendly' country in the EU (in 5th place overall) and Malta the least friendly (in 161st place)[9]. The 10 most business-friendly Member States (all in the top 30 worldwide) are the three Nordic countries, the three Baltic States, the UK, Ireland, Germany and the Netherlands. The five least friendly are Malta, Croatia, Czech Republic, Romania and Greece.

Important elements included in the indicator are the amount of time, the number of procedures and the costs and capital needed to start a business. In the EU, this requires an average of 13 days and 5.4 separate procedures and costs the equivalent of 4.4% of national income per head with minimum paid-in capital amounting to 10% of the latter. The difference between Member States is substantial. In Lithuania and Ireland, half the number of procedures are required at a fraction of the cost compared with the Czech Republic and Malta (Table 1).

Table 1 Starting a business in 2014

Country	Rank	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in Min. Capital (% of income per capita)
Lithuania	11	4	6.5	0.9	0
Ireland	12	4	10	0.3	0
Czech Republic	146	9	19.5	8.2	29.5
Malta	161	11	39.5	10.8	1.5

8 These are starting a business, dealing with construction, enforcing contracts and resolving insolvency, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders.

9 World Bank, Doing Business 2014.

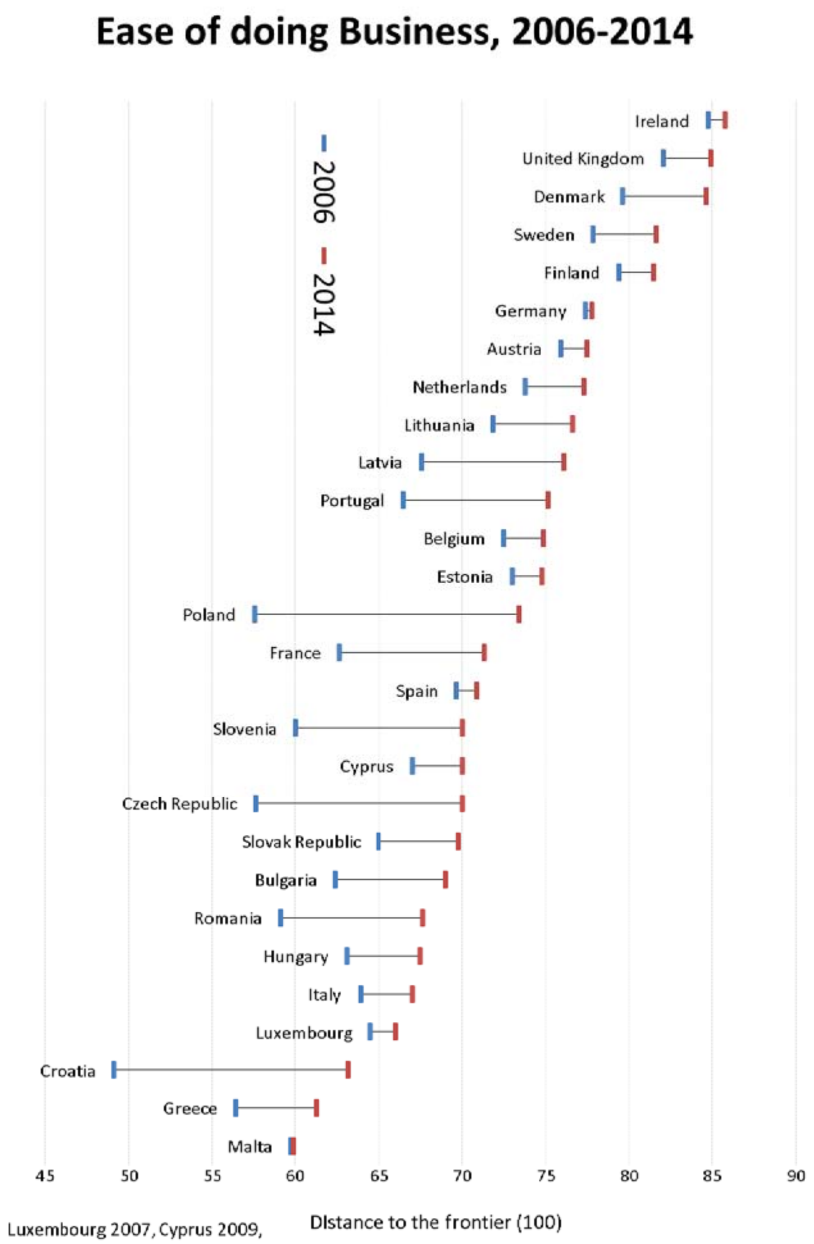
EU-28	70	5.4	12.9	4.4	10.4

Source: Doing Business 2014, World Bank

Box Ease of doing business varies within a country

The World Bank now assesses the ease of doing business in different locations in a growing number of countries. The variation in Italy, in particular, is marked. For example, to obtain the construction permits to build a warehouse requires 164 days in Bologna at a cost equivalent to 177% of income per head but 208 days in Potenza at a cost of 725% of income per head. Enforcing a contract takes an average of 855 days and costs 22% of the claim in Turin as compared with 2022 days and a cost of 34% of the claim in Bari. Starting a business varies from 6 days in Padua to 16 days in Naples, while registering a property takes 13 days in Bologna but 24 days in Rome.

Figure 1: WB Doing Business, 2006-2014



Between 2006 and 2014, all Member States improved their position in relation to the ideal as regards the ease of doing business (measured as 100 in Figure 67, i.e. where the best approach is adopted for all aspects). The biggest improvements occurred in a number of the countries furthest from the ideal - Croatia, Poland, Czech Republic and Slovenia, though Portugal, France and Romania also showed large improvements.

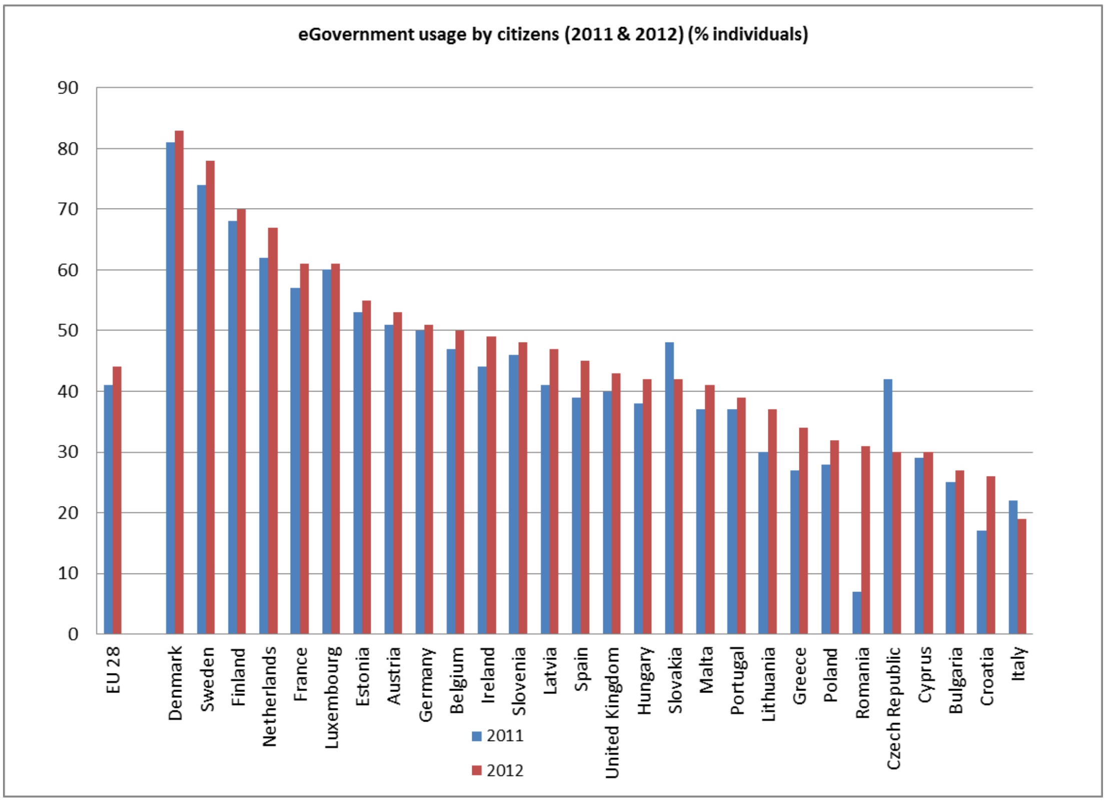
The ease of doing business, however, also varies between places within countries as a result of differences in the way national regulations are implemented (see Box). There is a need, therefore, to reduce differences in the ease of doing business not only between countries but also between regions or cities within countries.

Box on E-Government and public e-Tendering can improve the ease of doing business and reduce costs

E-Government allows public authorities to provide services more transparently and more cost-effectively. The EU's Digital Agenda for Europe includes the goal of increasing the use of e-Government services to 50% of EU citizens by 2015.

In 2012, 44% of the population in the EU made use of e-Government services. Between 2011 and 2012, the share increased in all but three countries (Figure 68). The increases were biggest in Romania (+24 percentage points), Croatia (8 percentage points) and Greece (7 percentage points), but the overall shares remain small. Italy had the smallest share of people using e-Government services in 2012 (18%), which was smaller than in 2011

Figure 2 e-Government usage by citizens, 2011-2012



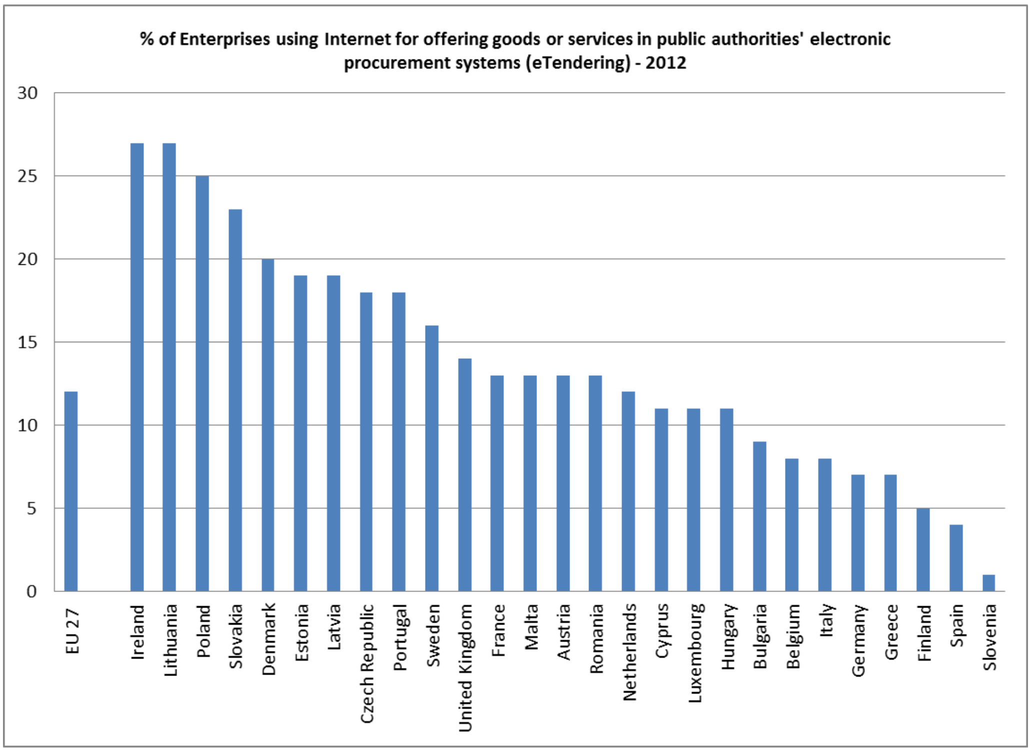
Source: Eurostat

E-procurement

The adoption of e-procurement – the use of electronic communication by government to buy supplies and services or to tender for public works – can generate significant savings for European taxpayers. As part of the modernisation of European public procurement, the Commission has accordingly proposed to make e-procurement the standard method in the EU by mid-2016.

Despite the benefits, e-procurement is still in its infancy in the EU. It was used in only 5-10% of procurement procedures in 2012 and only 12% of enterprises across the EU used the Internet when tendering. In only four Member States (Ireland, Lithuania, Slovakia and Poland) was the proportion above 20%

Figure 3 Enterprises using the internet in public e-Tendering, 2012



Source: Eurostat

3. MOST EUROPEANS THINK CORRUPTION IS WIDE SPREAD AND A MAJOR PROBLEM

The recent EU Anti-Corruption report[10] emphasises that corruption affects all Member States, but that it cannot be addressed by a one-size-fits-all policy because of the big difference in the nature and extent of corruption between Member States. Corruption harms the Union as a whole. It distorts the single market, reduces public finances and lowers investment levels. The issue is particularly relevant for cohesion, since less developed regions and Member States tend to score poorly on corruption and governance indicators.

The majority of the EU population see corruption as a major problem in their country (see figure). In all but five Member States (the Nordic countries, the Netherlands and Luxembourg), over 60% of people see corruption as a major problem, the proportion varying between 61% (in Germany) and 99% (in Romania).

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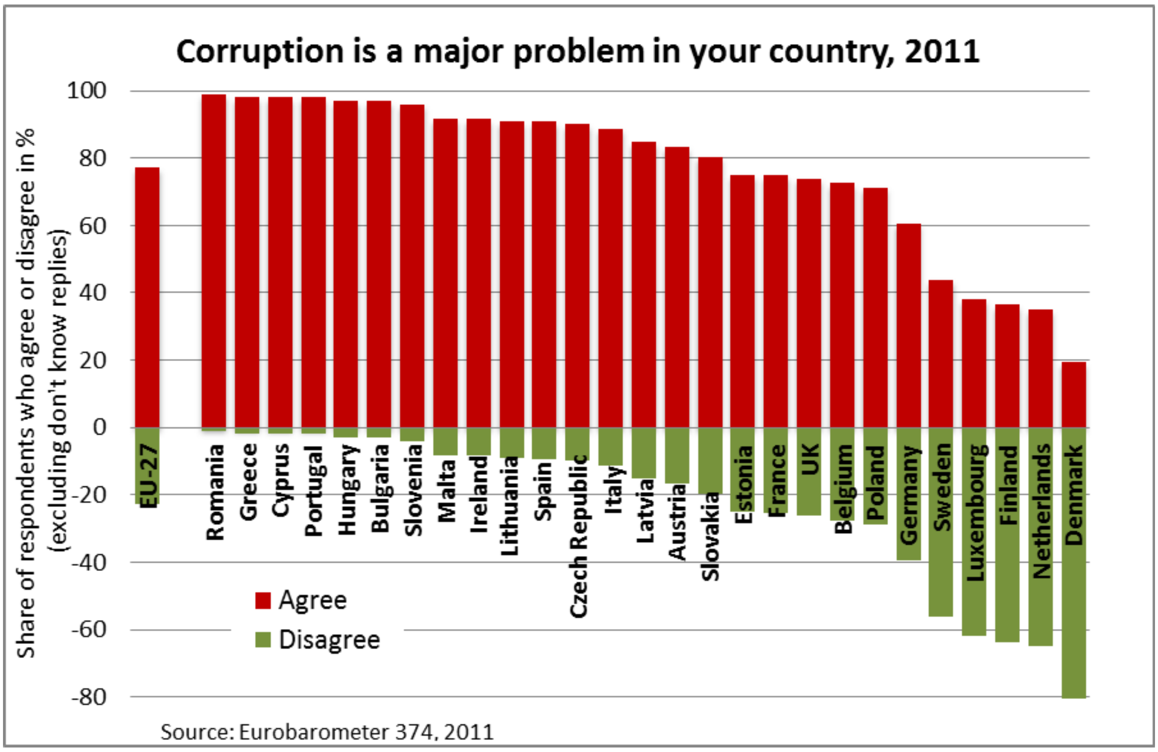
10 European Commission, 2014, *EU Anti-corruption Report*, COM (2014) 38

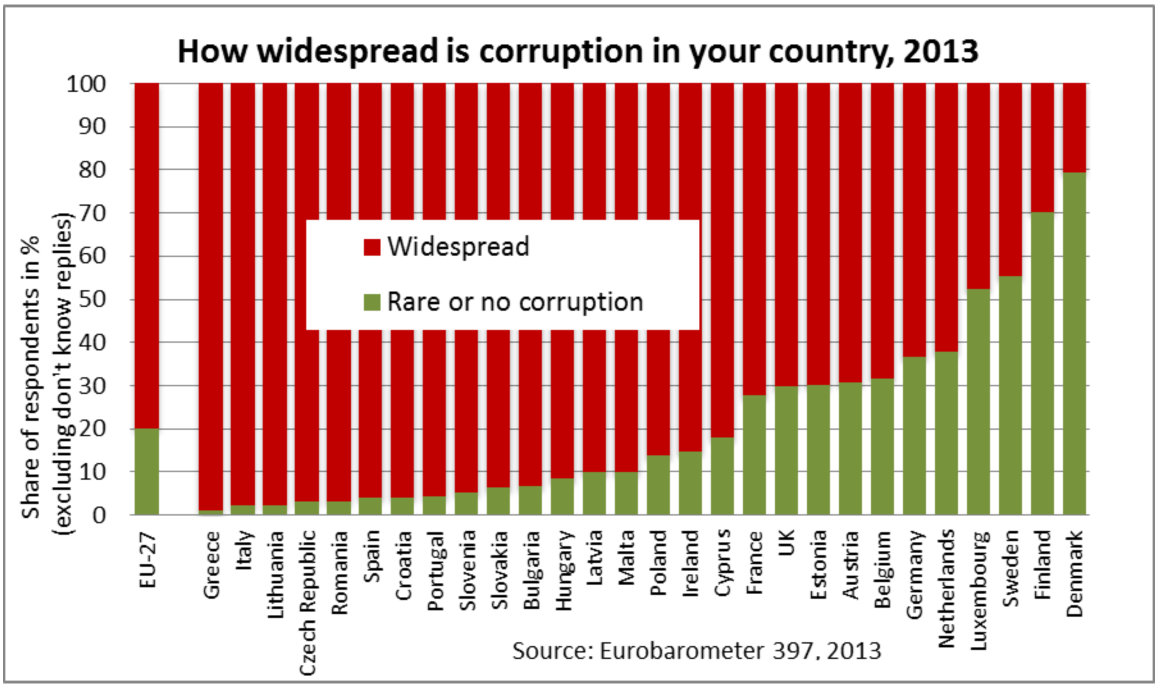
Figure 4: Corruption is a major problem, 2011



In 2013, four out of five people in the EU considered that corruption was widespread in their country. As in 2011, the Nordic countries had the lowest perceptions of corruption. In half of the Member States, nine out of ten people thought that corruption was widespread or very widespread.

The perception of corruption, however, can be heavily influenced by recent political scandals or by the financial and economic situation, which is less the case for direct experience of corruption or witnessing it at first hand. Only 8% of people in the EU surveyed had experienced or corruption or witnessed it in the previous twelve months. The figure, however, was significantly higher in 9 Member States, ranging from 12% in Cyprus to 25% in Lithuania.

Figure 5 How widespread is corruption in your country, 2013

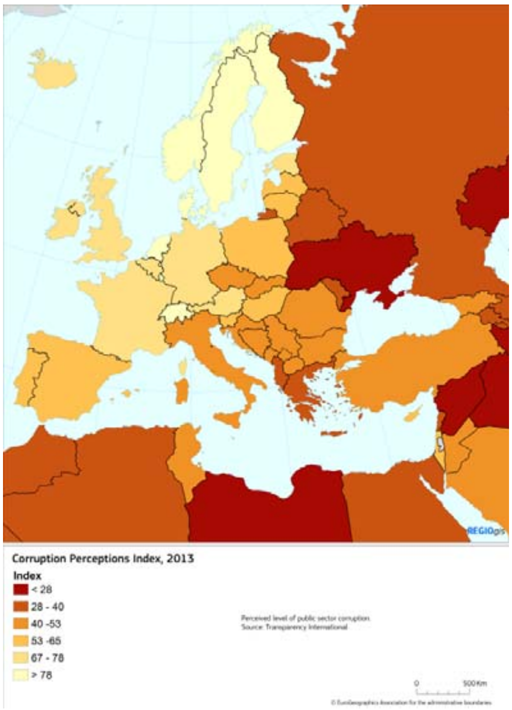


Despite the view that corruption is widespread and problematic, in a global perspective most EU Member States score relatively well on the Corruption Perception Index[11] (CPI), created by Transparency International[12] and covering 177 countries. The top 20 least corrupt countries according to the 2013 index include 8 EU Member States (the three Nordic Member States, the Benelux countries, Germany and the UK). Seven Member States, however, have relatively low scores and are ranked between 57 and 80. These, in descending order, are Croatia, the Czech Republic, Slovakia, Italy, Romania, Bulgaria and Greece.

[11] This index averages the standardised scores of up to 13 surveys of citizens and businesses on the perception of corruption in the public sector. A high score means a low perception of corruption.

[12] As also mentioned in the study 'Public Procurement: costs we pay for Corruption' (http://ec.europa.eu/anti_fraud/documents/anti-fraud-policy/research-and-studies/identifying_reducing_corruption_in_public_procurement_en.pdf).

Map 1: Corruption Perception Index, 2012



In addition, the study *Identifying and reducing corruption in public procurement in the EU*[13], commissioned by the European Commission at the request of the European Parliament shows that about 20% of the GDP of the EU is spent through public procurement (EUR 2.4 trillion at 2010 prices). Given these figures, the EU anti-corruption report concluded that public procurement is a hot spot for corruption. The study focussed on a number of areas in which considerable amounts of EU funding are spent through public procurement, in particular road and rail transport, water and waste management, urban and public utility construction and training. Table 20 shows the estimated effect of corruption in these areas.

Table 2 Estimated direct costs of corruption in public procurement

Direct costs of corruption in public procurement		
	Direct costs of corruption (in million EUR)	*% of the overall procurement value in the sector in the 8 Member States*
Road & rail	488 –755	1.9 % to 2.9%
Water & waste	27 –38	1.8% to 2.5%
Urban/utility construction	830 - 1 141	4.8% to 6.6%
Training	26 –86	4.7 % to 15.9%
R&D	99 –228	1.7% to 3.9%

[13] http://ec.europa.eu/anti_fraud/documents/anti-fraud-policy/research-and-studies/identifying_reducing_corruption_in_public_procurement_en.pdf

Corruption varies between policy areas, some being more prone to fraud than others. Training is the most vulnerable, the estimated loss of public funds from corruption ranging from just under 5% of the total spent to almost 16%.

The study also examined several types of indicator – or 'red flags' – which signal corruption, the most common one being bid rigging where competitors collude to ensure that one of them wins the contract being tendered. In the case of training, the most common 'red flag' are kick-backs, or payments to the public officials awarding the contract. A conflict of interest in procurement occurs when public officials or their family members own shares in the winning company. If a public official ignores that a contractor overtly does not execute a required task, this is considered as deliberate.

Table 3 Type of corruption by policy area

	Bid rigging	*Kick-backs*	*Conflict of interest*	*Deliberate Mismanagement*
Urban/utility construction	19	14	11	3
Road & Rail	10	8	4	1
Water & Waste	15	6	3	0
Training	1	3	2	1
R&D	12	4	2	0
Total*	57	35	22	5

The study also concluded, however, that EU-funded projects are less prone to corruption because of the management and control systems which are required to be implemented and the anti-fraud measures covering EU-funded expenditure.

Box: Ways of tackling corruption

A recent study by ANTICORRP, which analysed corruption in Romania, Hungary and Estonia, underlines the fact that an anti-corruption policy to be effective needs to be part of a broader strategy of improving governance. Repression, special legislation or an anti-corruption agency does not by itself automatically have a significant impact on corruption. Nor is it easy for an outside body to do much directly though it can help to influence things.

A good starting-point for reducing corruption is to reduce the administrative opportunities for discretionary behaviour. E-Government and public e-tendering can help in this regard, as can administrative reforms to cut red tape and streamline regulations. Improving the ease of doing business can, therefore, also help to combat corruption in part by limiting the opportunities for it to occur.

The participation and cooperation of the private and voluntary sectors can increase the social pressure against corruption. Concerned individuals can also help to maintain an independent judiciary and a high level of public accountability. The media are particularly important since they can act as a watchdog over governance, though they need to be economically independent and pluralistic to do so.

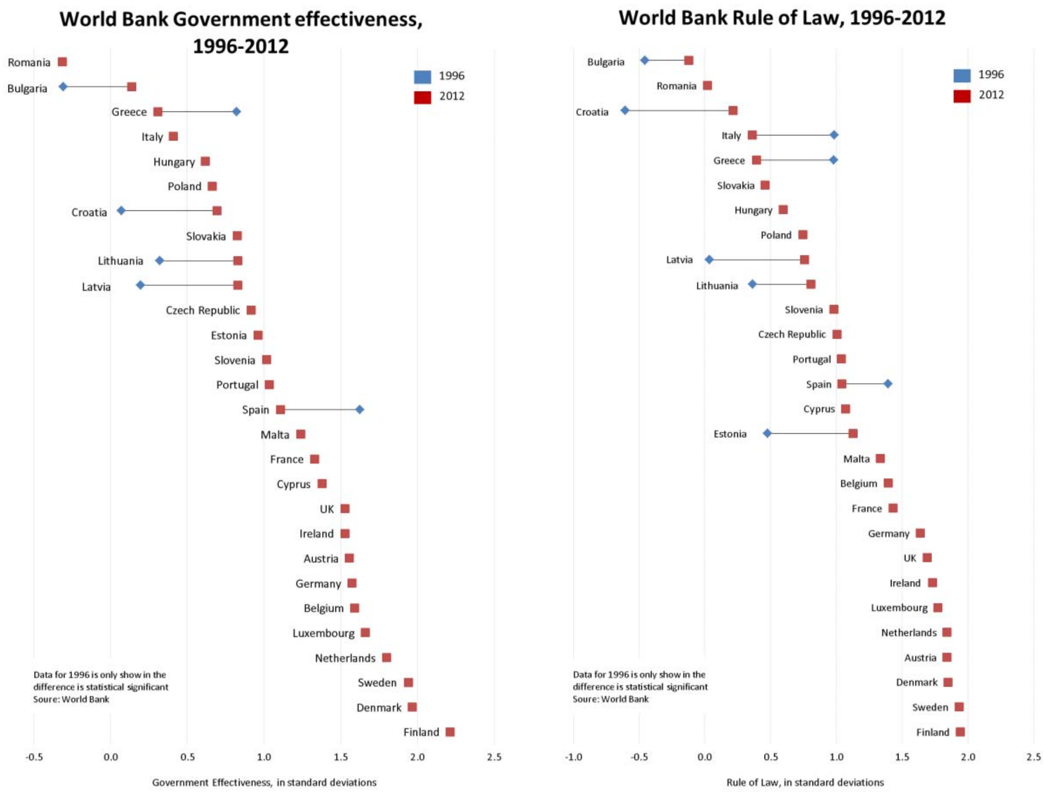
4. GOVERNANCE INDICATORS VARY BETWEEN AND WITHIN EU MEMBER STATES

The World Bank Governance Indicators, which cover over 200 countries, consist of six measures: Political stability, Government effectiveness, Regulatory quality, Rule of law, Control of corruption and Voice and accountability.

The indicator of Government effectiveness (which measures public perception of the government's capacity to provide high standard public services, the efficiency and independence of the civil service and the ability to manage the creation and implementation of public policies), is especially relevant for economic development and varies considerably between EU Member States (Figure 72). It shows the three Nordic countries as having the most effective governments and Romania, Bulgaria, Greece and Italy as having the least effective. It also shows little change for most Member States between 1996 and 2012 and an improvement in Lithuania, Bulgaria, Latvia and Croatia, if from a low starting-point. It shows, however, a significant deterioration in government effectiveness in Greece and Spain, which might be a result of the economic crisis

The 'Rule of law' indicator, which measures public perception of how laws are implemented and how well they are enforced, also varies between Member States and in a very similar way to how government effectiveness is perceived. The three Nordic countries have again the highest scores and Romania, Bulgaria, Greece and Italy the lowest, along with Croatia. There are similarities as well in the changes which occurred between 1996 and 2012, with significant improvements in Bulgaria and Croatia – though the score in both remaining low – as well as in the three Baltic States, and a significant deterioration in Greece and Spain, as well as in Italy.

Figure 6: World Bank, Government effectiveness and Rule of Law, 1996-2012



4.1. Some regions have a far higher (or lower) quality of government

As indicated above, there are variations across regions in the way that national regulations are implemented, which reflect differences in the efficiency of regional and local authorities. These differences are also important to take into account when assessing the quality of governance in relation to economic and social development.

A new regional index, constructed by the Gothenburg Institute of Quality of Government, enables this to be done. The results are disturbing, in that 15% or more of respondents in many regions in Bulgaria, Romania, Hungary and Italy report that they had personally paid a bribe in the preceding 12 months. The perceived quality of government varies markedly between regions in Italy, Spain, Belgium, Romania and Bulgaria. In the first three, it was rated to be lowest in the less developed regions, implying perhaps that they may be stuck in a low-administrative quality, low-growth trap. In Romania and Bulgaria as well as Hungary, the capital city region was more poorly rated than others, reflecting perhaps the greater opportunities for corruption there.

In the countries with the highest perceived quality of government - the three Nordic countries and the Netherlands – there were no great differences between regions.

The situation in the outermost regions differs between countries. While the Portuguese ones are rated the same as the national average (Acores) or higher (Madeira), the Spanish (Canarias) and the four French ones are rated below.

The results of the 2013 survey are much the same as for 2010[14], which, when it was published, spurred a lot of research on the link between the quality of government in regions and their rate of innovation, entrepreneurship and growth. Some of the key findings of this research are set out in the OECD 2013 report *Investing Together*, which concluded that a low quality of government hinders economic development and reduces the impact of public investment. This applies equally to the investment co-financed under Cohesion Policy, implying that its effect on regional development could be enhanced by improvements in the quality of governance. Such improvements, however, will not necessarily come about merely through the passage of time but are likely to require concerted efforts at all levels of government as well as the active involvement of the public and the media.

[14] Due to slight changes in the methodology the two surveys are not fully comparable.

Box How does European quality of Government index constructed?

This index, commissioned by DG Regional and Urban Policy and first published in 2010, combines World Bank Governance indicators at the national level with a survey that captures regional variations within each country. As a result, the national average of the regional indices equals the World Bank Governance score.

It has been updated to 2013 with the support of the 7th Framework Programme[15]. The survey focuses on the public services which are often controlled locally or regionally (law enforcement, education and healthcare) and which are more likely to vary between regions. Questions cover the quality and the impartiality of these services as well as the perception and personal experience of corruption.

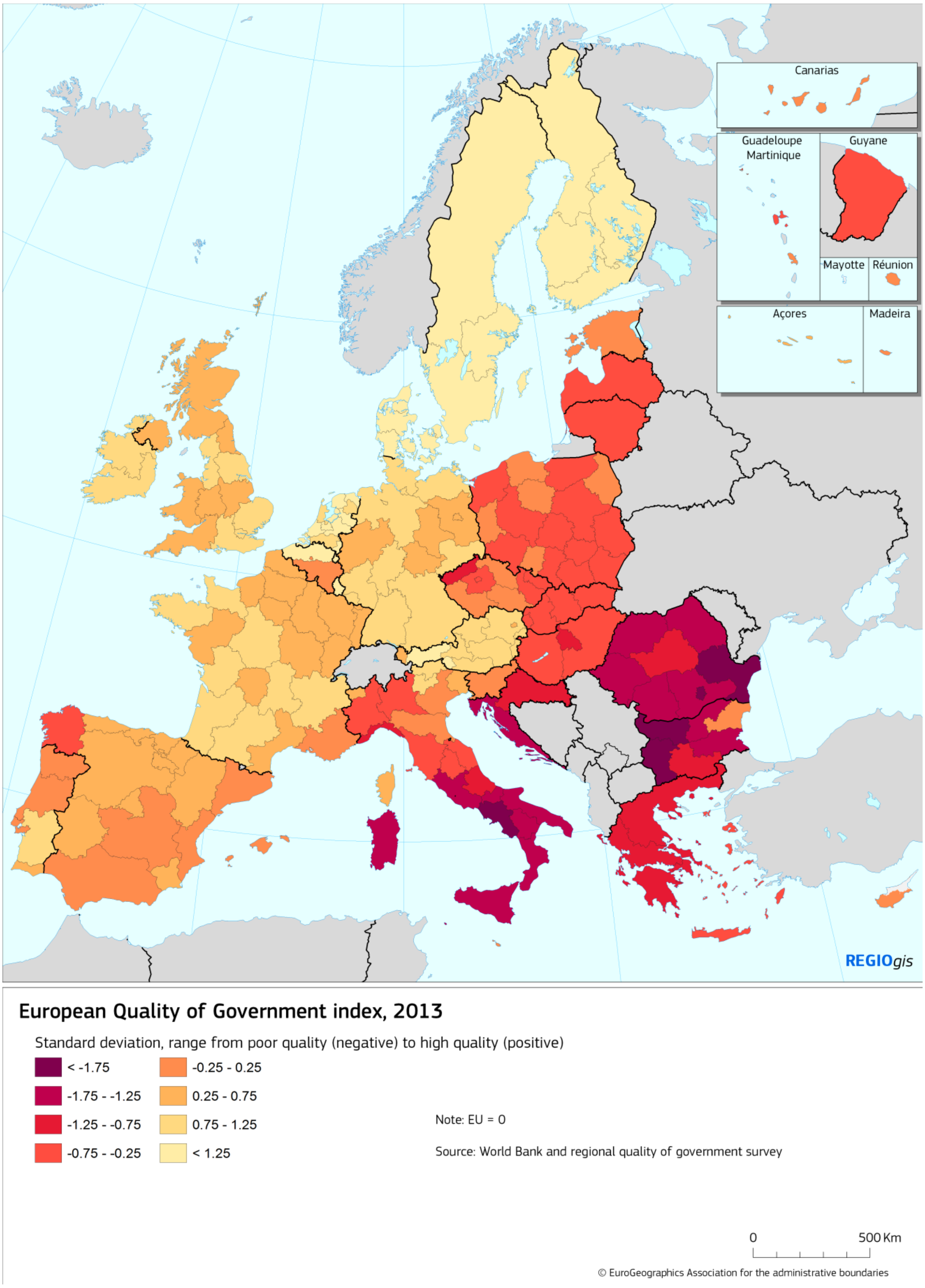
The questions[16] include **among others**:

- How would you rate **the quality** of public education in your area?
- Certain people are given **special advantages** in the public health care system in my area
- All citizens **are treated equally** by the police force in my area
- . In the past 12 months have you or anyone living in your household paid a **bribe**

[15] It is based on a survey of 85 000 respondents covering 24 countries and 212 regions. See ANTICORRP www.anticorrp.eu.

[16] See http://nicholascharron.wordpress.com/european-quality-of-government-index-eqi/ for more info.

Map 2 European Quality of Government index, 2013



4.2. The authority of EU regions is growing

There is a trend towards regionalisation in many parts of the EU. According to the regional self-rule index (see Box), regions in many Member States have become more autonomous over the past 50 years, especially in Italy, Belgium and Spain as well as Scotland in the UK, in all of which there were high levels of self-rule at regional level.

The degree of self-rule also increased substantially in regions in the Czech Republic, Slovakia, Poland, Greece and Finland but, nevertheless, remained relatively low.

In German and Austrian regions, there were only minor changes, though the high level of self-rule was already high in 1960. No real change occurred in regions in England, Sweden, mainland Portugal, Croatia and Bulgaria (Map 79).

In 2011, the regional self-rule index was highest in the Federal States of Germany, Austria and Belgium. It was second highest in 'Regional States', which are more centralised than federal ones, but less so than unitary ones. It was particularly high in the most autonomous regions, such as Åland in Finland, Scotland in the UK, Navarra in Spain and Açores and Madeira in Portugal. The index was lowest in Bulgaria, mainland Portugal and Ireland[17].

In addition to the degree of self-rule, the regions covered by the index also differ in the size of their population. In Germany, France, Italy, Spain and Poland, all or virtually all the regions have a population of over one million. In the UK, however, as well as in Bulgaria, Croatia and Finland, the majority of regions distinguished have a population below 250 000.

In 2011, regions in around half the Member States had some autonomy over borrowing. It was greatest in the German Länder and the Italian regions, which in both cases can borrow without restriction, while regions in France, the Netherlands, Hungary and Sweden, as well as Scotland, can borrow without prior authorisation of the central government but within specified limits. For regions in the Czech Republic, Croatia, Poland, Romania, Spain and England, as well as for Wales, borrowing requires both prior authorisation and is limited in amount. In the other 9 Member States which have regions, these are not able to borrow at all.

In 2011, only Navarra and the Basque provinces in Spain had a high level of fiscal autonomy, in that they were able to decide the base and the rate of at least one major tax (personal income, corporate, value added or sales tax). A few other regions (the other Spanish regions, Belgian and Italian regions, Åland in Finland, Açores and Madeira in Portugal, the Län in Sweden and Scotland) were able to set the rate of at least one major tax, if within limits, but not the base. The German Länder were able to decide the base and the rate of minor taxes, while regions in Croatia, France, Hungary, Italy, Netherlands, Romania, Slovakia and England were able to set the rate, but not the base.

17 The three Baltic States, Luxembourg, Slovenia, Cyprus and Malta did not have regions in 2011 according to the regional definition used by the researchers (average population of min 150 000).

In Bulgaria, Czech Republic, Denmark, Finland (apart from Åland), Greece, Hungary, Ireland, Poland, mainland Portugal, Romania, Northern Ireland and Wales, the base and the rates of all local or regional taxes are set by central government.

The regional self-rule index covers the changes up to 2011 and shows that the crisis has had an effect on this. In some cases, regions have been granted more powers and responsibilities, while in other cases central governments have increased their control over regional authorities, by, for example, limiting their capacity to borrow money.

A point to note, however, is that the index does not capture the full extent of decentralisation as it does not measure the degree of self-rule of local authorities. Given the growing role of cities and metropolitan areas in governance, this is an aspect which the Commission intends to investigate further.

Box: The regional self-rule index

The index captures the area over which a government exercises authority, the extent of this (degree of independence) and the spheres of action over which it is exercised.

The territorial scope of authority distinguishes self-rule (a government exercising authority within its own jurisdiction) and shared rule (a government co-exercising authority over a larger jurisdiction of which it is a part).

The extent of authority measures the degree to which a government has independent legislative, fiscal and executive responsibility, the conditions under which it can act unilaterally and its capacity to override central government decisions.

The spheres of action indicate the range of policies over which a regional government has authority – taxation, borrowing and constitutional reform, in particular.

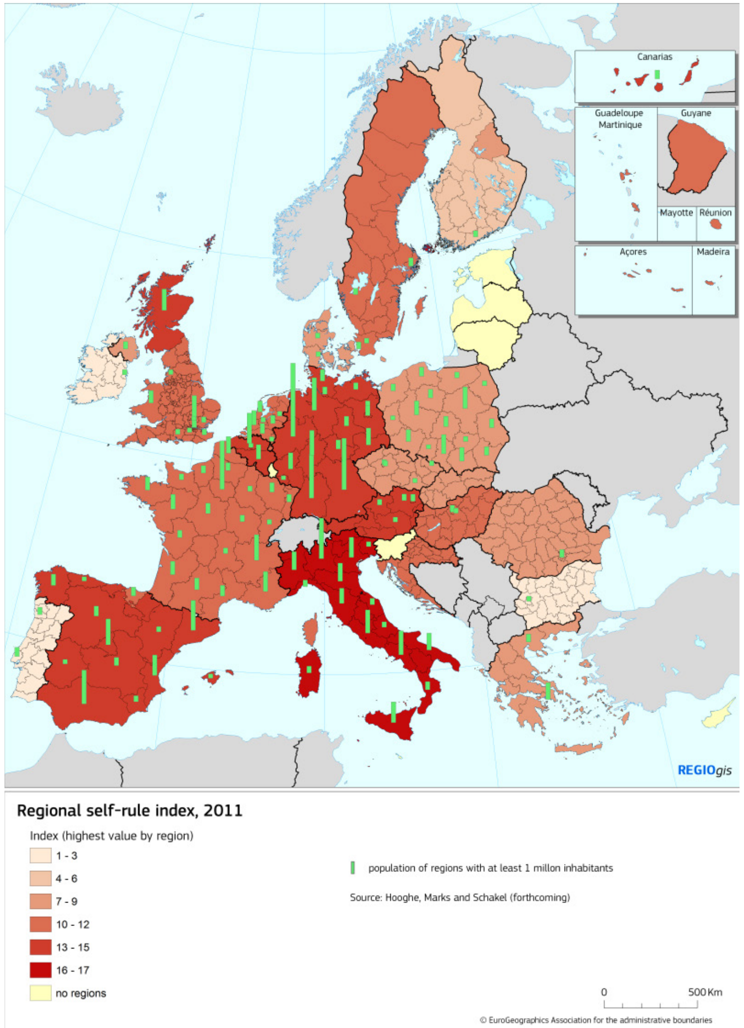
The regional self-rule index covers five dimensions (see table).

Table 4 Dimensions of regional authority (self-rule)

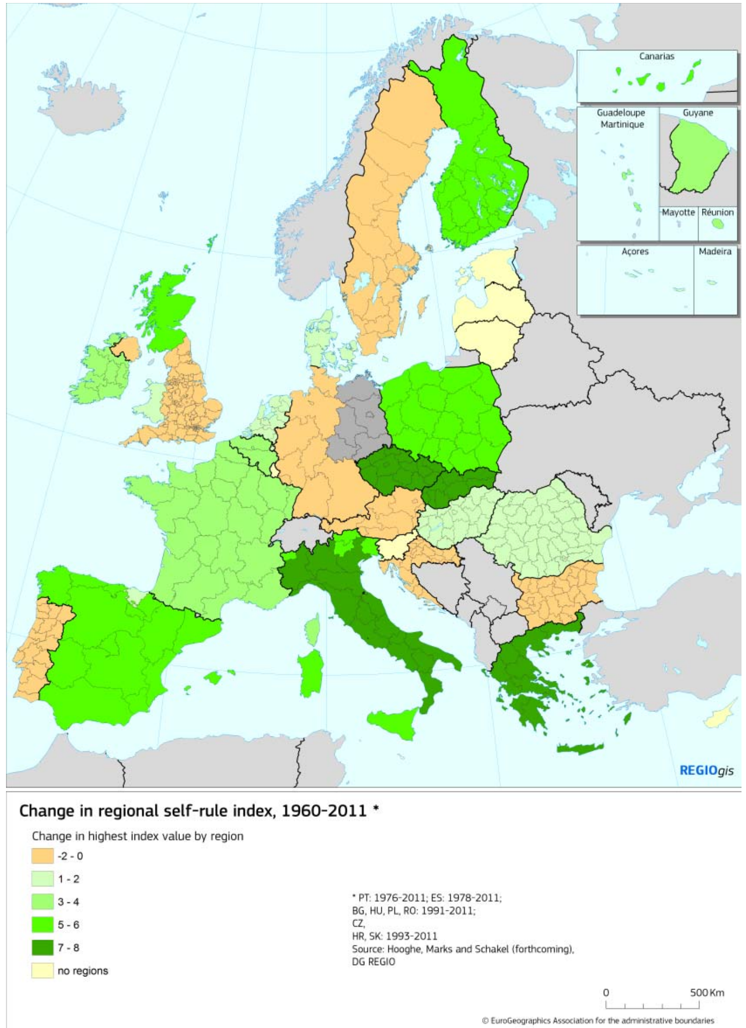
Self rule	**The authority exercised by a regional government over those who live in the region**
Institutional depth	The extent to which a regional government is autonomous rather than appointed by the national government
Policy scope	The range of policies for which a regional government is responsible.
Fiscal autonomy	The extent to which a regional government can independently tax its population.
Borrowing autonomy	The extent to which a regional government can borrow
Representation	The extent to which a region has an independent legislature and executive

Source: Hooghe, Liesbet, Gary Marks, Arjan H. Schakel, Sandra Chapman, Sara Niedzwiecki, Sarah Shair-Rosenfield (forthcoming). *Governance Below the State: Regional Authority in 81 Countries*. Oxford: OUP.

Map 3 Regional self-rule index, 2011



Map 4 Change in regional self-rule index, 1960-2011



Box: OECD Principles: Effective public investment: A shared responsibility across levels of government

The OECD has recently approved a set of principles for public investment which, for the first time, cover sub-national governments, so recognising the important and growing role of regional and local authorities in planning and implementing public investment. The recommendations need to be seen in the context of the crisis, which has reduced public investment in many countries and put more emphasis on ensuring value for money. These principles will be monitored every three years by the OECD committees and though not legally binding, they have some moral force.

Effective public investment requires close co-ordination across levels of government to bridge information, policy or fiscal gaps which may occur. It also requires the capacity at different administrative levels to design and implement public investment projects. The principles, therefore, relate to how to coordinate public investment across levels of government, how to strengthen the capacity to carry it out and how to ensure a sound framework for planning it.

Since public investment projects are rarely planned, financed and implemented by a single authority, different levels of government at various stages of the process are involved which accordingly need to work together. Public investment also tends to require involvement at local level even when carried out by central government since it is essential to take account of local needs, possible bottlenecks and particular territorial factors if it is to be effective. Accordingly, even if they have no funding or decision-making responsibilities, local authorities can increase (or reduce) its results and impact.

To help countries address these challenges, the OECD has developed a set of Principles on Effective Public Investment Across Levels of Government. The goal is to help governments at all levels to assess the strengths and weaknesses of their public investment capacity and to set priorities for improvement. The Principles are combined into three groups, which represent systemic multi-level governance challenges for public investment:

a) **Co-ordination challenges**: Cross-sector, cross-jurisdictional, and intergovernmental co-ordination is necessary but difficult in practice. The constellation of actors involved in public investment is large and their interests may need to be aligned.

b) **Capacity challenges:** Where the capacity to design and implement investment strategy is weak, policies may fail to achieve their objectives. Evidence suggests that public investment and growth outcomes are correlated with the quality of government, including at the sub-national level.

c) **Challenges in framework conditions:** Good practice in budgeting, procurement and regulation is integral to successful investment but is not always consistent across levels of government.

OECD Principles on effective public investment across levels of government

OECD Member countries should take steps to ensure that national and sub-national levels of government use resources for public investment on territorial development effectively, in accordance with the Principles set out below:

Coordinate public investment across levels of government and policies

- Invest using an integrated strategy tailored to different places.
- Adopt effective means of coordination across national and sub-national governments.
- Co-ordinate among sub-national governments to invest at the relevant scale

Strengthen capacity for public investment and promote policy learning across levels of *government*

- Assess upfront the long-term effects and risks of public investment.
- Encourage stakeholder involvement throughout the investment cycle.
- Mobilise the private sector and financing institutions to diversify sources of funding and strengthen capacity.
- Reinforce the expertise of public officials and institutions throughout the investment cycle.
- Focus on results and promote learning.

Ensure sound framework conditions for public investment at all levels of government

- Develop a fiscal framework adapted to the investment objectives pursued.
- Require sound, transparent financial management.
- Encourage transparency and strategic use of public procurement at all levels of government.
- Strive for quality and consistency in regulatory systems across levels of government.

More information at: http**://www.oecd.org/gov/regional-policy/oecd-principles-on-effective-public-investment.htm**

5. POOR GOVERNANCE LIMITS THE IMPACT OF COHESION POLICY

A lower standard of governance can affect the impact of Cohesion Policy both directly and indirectly. In the first place, it can reduce expenditure if programmes fail to invest all the funding available. Secondly, it can lead to a less coherent or appropriate strategy for a country or region. Thirdly, it may lead to lower quality projects being selected for funding or to the best projects not applying for support at all. Fourthly, it may result in a lower leverage effect because the private sector is less willing to co-finance investment.

A poor quality governance system is not the same as one which is corrupt or fraudulent, although it may be both. Nor does it necessarily involve illegalities. A slow decision-making process, badly organised public consultations, a focus on short-term electoral gain over a longer-term development strategy and frequent changes in policies and priorities can be perfectly legal but they, nevertheless, tend to undermine the impact of Cohesion Policy.

5.1. Poor governance can slow down investment, leading to funding losses

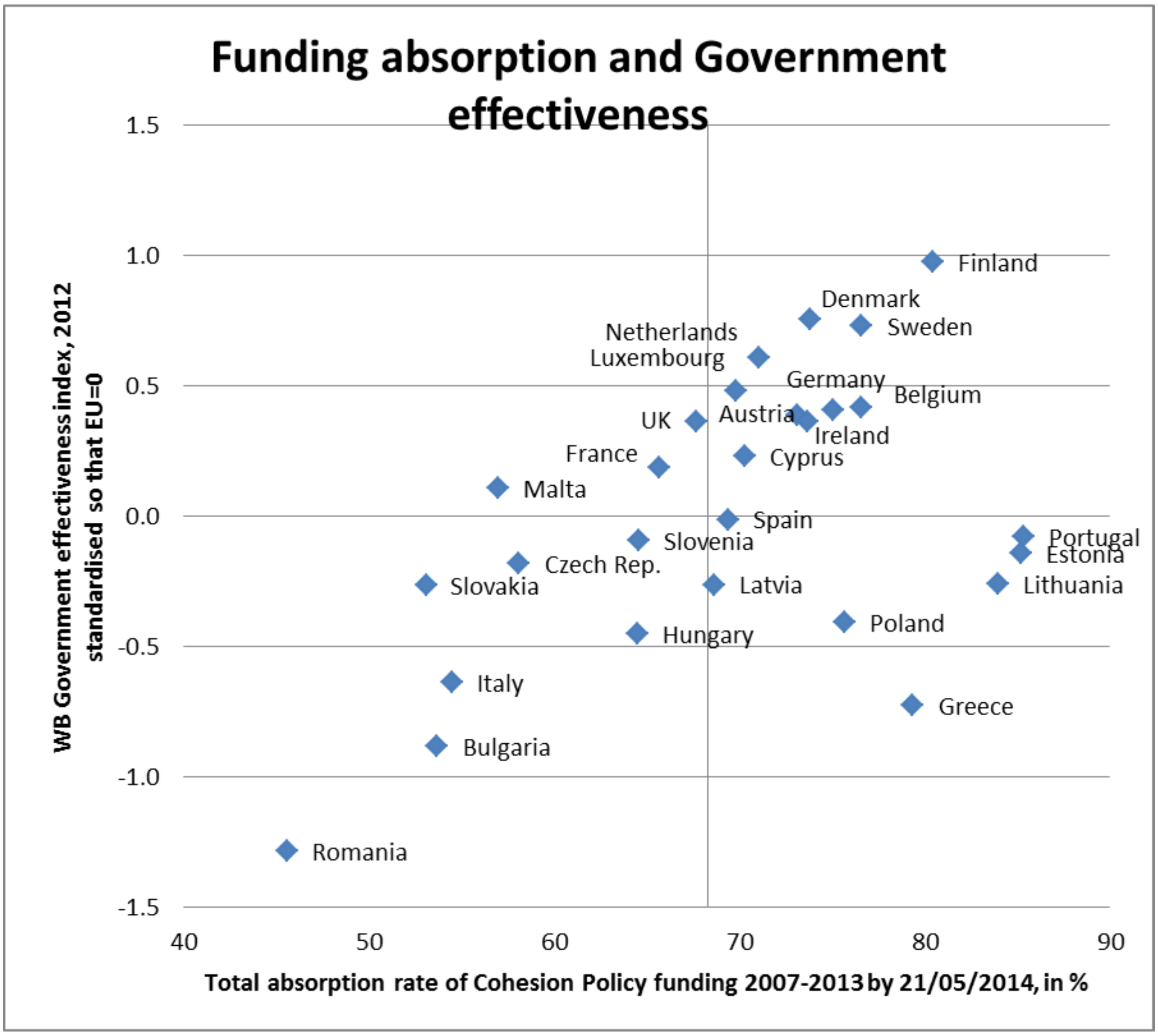
According to the latest data available (21 May 2014), Member States, on average, had absorbed (or spent) only 68% of the EU funds available for the 2007-2013 period[18]. Romania had absorbed only 46% of funds and Slovakia, Bulgaria, Italy, Malta and the Czech Republic, less than 60%. By contrast, Finland, Estonia, Latvia and Portugal had absorbed over 80%. The slow rates of absorption in the countries

[18] In the sense of claiming and receiving payment for expenditure carried out under the Structural Fund and Cohesion Fund programmes. These figures include advance payments.

concerned could be due to a number of reasons, not least a lack of competence in Managing Authorities, or Governments more generally, or insufficient staff. Whatever the reason, it could mean that Member States are unable to spend the funding available to them in the time allowed and accordingly lose some of it (under the decommitment, or 'n+2', rule) or spend the funding inefficiently in an attempt to spend it in time.

Relating the rates of absorption of funding to the World Bank Government effectiveness index suggests that there may be a link (Figure 73). Seven Member States are below average for both government effectiveness and absorption (EU-27 average is 68%), while 10 are above average for both. On the other hand, Estonia, Lithuania and Portugal have the highest absorption rates but a government effectiveness rate which is below average, if only just. It is possible that being small and having a limited number of Managing Authorities facilitates achieving a high absorption rate, though this does not seem to have helped Malta or Latvia.

Figure 7 Cohesion Policy funding absorption and Government effectiveness, 2014



Sources: World Bank and SFC

Many of the difficulties of managing Cohesion Policy programmes are of an administrative nature related to human resources, management systems, coordination between different bodies and the proper implementation of public procurement. Overall staff numbers vary widely between Managing Authorities, which differ too in the extent to which they rely on in-house as opposed to outside staff and whether there are dedicated or partially-dedicated personnel in particular roles (managing, certifying, auditing and implementing).

Problems caused by simply not having enough appropriately qualified personnel can be long-term and systemic (as in Bulgaria or Romania, for example) or temporary (as in the case of auditing in Austria). High turnover of staff is a recurrent problem at all administrative levels, particularly in some EU-12 countries. In several countries, funding for technical assistance is used to pay salaries or even bonuses to strengthen particular functional areas (which has prompted the launching of a study by the Commission to clarify the situation).

The adoption of modern management systems to provide incentives for good performance and to hold managers accountable for results is patchy. In some countries, systems to avoid conflicts of interest or prevent corrupt practices by public officials are weak. Computerised methods to improve efficiency and transparency in the use of EU funds are well developed in a number of countries but almost non-existent in others. In general, financial monitoring and control systems function well, but those monitoring outcomes and results work less well, though there are several examples of good practice which can be built on in the present programming period.

Strategies developed to meet EU policy objectives are sometimes not adhered to because of political pressure. In some countries, particular efforts are needed to strengthen both project pipelines (selection criteria, project preparation and tendering) and implementation (contracting and project management).

In a number of Member States, it has proved difficult to carry out major projects within the time limits set for expenditure to be eligible for co-financing. A common problem is that regional and local authorities have limited capacity to prepare and implement complex projects, so that efforts to build capacity need to be targeted at all administrative levels and not just the national.

Systematic weaknesses in all aspects of public procurement are the single most common cause of the irregularities found during audit, resulting in suspension of payments and financial correction. Several Member States have demonstrated limited capacity to implement the Environmental Impact Assessment and Strategic Environmental Assessment Directives as well as to apply State Aid rules correctly, with EU-12 countries usually requiring more support (which is also likely to be the case for Croatia in the new period). Frequent problems occur, in particular, in respect of railways, solid waste, wastewater, RTDI, ICT and financial instruments.

Problems of coordination can occur between different national horizontal (i.e. sectoral) programmes as well as between national and regional programmes. In addition, the delegation of tasks by Managing Authorities to intermediate bodies can become overly complex and dilute accountability.

5.2. Poor governance can reduce the leverage effect of Cohesion Policy

Spending the funding available is a necessary but not sufficient step for achieving a strong impact of Cohesion Policy. This also depends on what the funding is spent on, whether the projects concerned deliver value for money and whether there is general confidence that they will be completed.

The skill and intent of the politicians and the national and regional authorities responsible for managing the funds are important here. The lack of skills can be overcome by training and hiring more staff, so long as the need to do so is recognised (Rodríguez-Pose and Storper, 2006[19]). The deliberate intent of a government and/or an authority to pursue goals other than providing the public goods and services needed by people is more difficult to combat – a situation described by Barca (2009[20]) as state capture.

High quality governance creates a virtuous cycle, in which people trust the government to make the right choices and to spend their taxes in the most cost-effective way which leads to wide participation in public calls for tender, so keeping down costs, and to business investment taking account of government policy (Acemoglu et al., 2012).

Low quality governance, on the other hand, creates a vicious cycle, in which trust in government breaks down, taxes are evaded, corruption is no longer reported, participation in public calls for tender declines as businesses assume they need the right connections or bribes to get contracts and the climate for investment is uncertain because of the unpredictability of government policy. To break such a vicious cycle, an outside shock or external support for local forces seeking to improve the quality of governance is often needed.

Recent empirical research (Rodriguez-Pose and Garcilazzo 2014[21]) shows the important role of the quality of government as a direct determinant of economic growth as well as a moderator of the efficiency of Cohesion Policy expenditure. According to the findings of the research, improving the quality of government in lagging regions is a fundamental precondition for increasing the impact of Cohesion Policy (see Box). The greater emphasis in the new programming period on

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[19] Rodríguez-Pose A. and Storper, M., 2006, *Better rules or stronger communities? On the social foundations of institutional change and its economic effects Economic Geography*, 82 (1). 1-25. ISSN 0013-0095

[20] Barca F., 2009, *An Agenda for a reformed cohesion policy: A place-based approach to meeting European Union challenges and expectations*, Independent Report, DG REGIO.

[21] Rodriguez-Pose, A. and E. Garcilazo 2013, *Quality of Government and the Returns of Investment: Examining the Impact of Cohesion Expenditure in European Regions*, OECD Regional Development Working Papers, No. 2013/12, OECD Publishing

improving the administrative capacity to manage funding and making this a condition for receipt of support is in line with this..

Box: The quality of government as a determinant of the effectiveness of Cohesion Policy

In a recent study carried out by Rodriguez-Pose and Garcilazzo (2014), real growth of GDP per head between 1995 and 2006 in EU-15 regions was analysed with the aid of an econometric model using panel data analysis. The aim was to identify the underlying determinants and to assess the role of i Cohesion Policy expenditure, the quality of government and the interaction between the two. The results indicate that expenditure had a significant impact on the growth of GDP per head and in the regions that received a substantial amount funding (mostly the less developed ones) the higher the quality of government, the greater the impact.

They also suggest that low quality of government is an obstacle that cannot be overcome by increasing spending and that improving the quality of government is essential for Cohesion Policy to have its full impact.

6. CONCLUSION

The ease of doing business, the level of corruption and the quality of governance varies substantially across EU Member States and regions. This limits the growth potential of those where governance is below average and hinders the proper functioning of the single market. Many people in the EU are seriously concerned about corruption even in countries with a good reputation for combating it and limiting the abuse of public power.

A wide range of indicators suggest that in a number of Member States (in the EU-15 as well as the EU-13) and regions, especially the less developed ones, the system of governance is of low quality, which hinders social and economic development and limits the impact of Cohesion Policy. The regional dimension of governance is of increasing importance in many parts of the EU as the authorities concerned acquire more autonomy and more responsibility for public expenditure. The principles of effective investment developed by the OECD in recognition of the major role of local and regional authorities in this respect indicate how the most impact can be obtained from investment spending.

The Commission along with the OECD and other international organisations has recognised the importance of improving governance at all levels across the EU and has taken steps on several fronts to this end, including through the new anti-corruption report and a stronger emphasis on this in the annual growth survey and in Cohesion Policy in the new period (see next chapter).