

Impact of EU Cohesion Policy in Central Europe

Oto Potluka et al.



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Konrad
Adenauer
Stiftung



ČESKO-POLSKÉ
FORUM
POLSKO-CZESKIE



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2010
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INTRODUCTION

The countries in Central Europe have witnessed dramatic political developments over the last 20 years. First were the political changes in the late 80's, which resulted in the ousting of the totalitarian political system and democracy. This over throw was followed by social and economic transformation during the 90's. The entry of those countries into NATO and their preparation for EU accession was a confirmation of democratic development. Development in Slovakia was slower, but in 2004 this country also joined both NATO and the EU.

The starting positions of each country were different. The transition countries also differed in regional differences. Those differences were driven mainly by the economic structure and the ability to quickly refocus the primary and secondary sectors to the tertiary sector and sectors with high added value.

The enlargement of the European Union in 2004 was an important historical turning-point not only for the new Member States, but also for the European Union. The accession countries witnessed many changes before the accession itself. The changes mainly concerned the Copenhagen criteria connected to the accession countries' preparedness to be members of the European Union. There were some policy fields, in which the accession countries could prepare, but without being EU Member States, the policies were not actually realized. Those policies are primarily the Common Agricultural Policy and the Cohesion Policy. The second one is the core topic of this publication.

The EU Cohesion Policy is one of the most visible EU policies, as the means of this policy are direct funds for development projects. This policy is important for the countries in Central Europe as the intensity of EU Cohesion Policy assistance calculated per capita in those countries is the one of the most intensive in the whole European Union (Barca 2009, p. 64). The concentration of the assistance is comparable in Portugal, and partly in Spain. Although the Visegrad countries (Poland, Hungary, Slovakia and the Czech Republic) only represent approximately one eighth of the whole EU population, more than one third of the overall allocation of the EU Cohesion Policy Funds goes to these countries.

There is discussion concerning the absorption capacity in the new Member States. The discussion is less about the formal ability of the Member States to spend the Structural Funds and Cohesion Fund allocations. Almost 100 % of the Structural Funds for the programming period 2000-2006 has been spent in the countries in question. But there is still a crucial question of the actual effect of the assistance (not only in the new Member States).

One aspect of this discussion is the concentration of the EU Cohesion Policy on the Lisbon Strategy and the contribution this policy makes to increasing competitiveness in the economies of the European Union and the option of supporting regions with a high potential for development or to support regions with development that is lagging behind.

Table I.1 Indicative allocation of EU Cohesion Policy by Visegrad countries and type of regions, 2007-13

Current prices in million EUR EU contribution	Convergence		Regional competitiveness and employment		European territorial cooperation	Total
	Cohesion Fund	Convergence	Phasing-in	Regional competitiveness and employment		
Czech Republic	8819	17064		419	389	26691
Hungary	8642	14248	2031		386	25307
Poland	22176	44377			731	67284
Slovakia	3899	7013		449	227	11588
Visegrad countries	43536	82702	2031	868	1733	130870
Total EU	69578	199322	11409	43556	8723	347410
Share of Visegrad countries to EU	62,57 %	41,49 %	17,80 %	1,99 %	19,87 %	37,67 %

Source: EC (2007), *Cohesion policy 2007-2013 Commentaries and official texts*, p. 25; own calculations

The distribution of aid mainly to investment projects in infrastructure compared to developing human resources is shown in the following table. This distribution shows the need for investment in basic infrastructure in the Visegrad countries is still high. This is despite the fact that knowledge and skills are a decisive factor for competitiveness in today's globalized World.

Table I.2 Indicative allocation of CF, ERDF and ESF by Visegrad countries

in billion EUR period 2007-2013 EU contribution	Convergence			Regional competitiveness and employment	
	CF	ERDF	ESF	ERDF	ESF
Czech Republic	8,8	13,4	3,6	0,3	0,2
Hungary	8,6	11,2	3,2	1,5	0,5
Poland	22	33	10	0	0
Slovakia	4	6	1	0,5	0,03
Visegrad countries	43,4	63,6	17,8	2,3	0,73

Source: DG Regio, own calculations

It has been more than six years since the largest enlargement of European Union. It enables us to discuss the impacts the EU Cohesion Policy has had on life in the new Member States. There was a delay in implementing this policy in 2004. Many project of the programming period 2004-2006 had been finished in 2008 in compliance with

the n+2 rule, eventually in 2009 according to the agreement between the European Commission and Member States. Thus, the present is suitable for doing an impact evaluation. There are some studies and documents evaluating the programming period 2000-2006 (for example EC 2010 or Barca 2009 among others). All the evaluations are used as a helpful tool for discussion about the future of the EU Cohesion Policy after 2014, which is now in progress.

It is probably too ambitious to use the word “impact” in the name of this publication. It is not possible to evaluate and discuss all the possible impacts in one publication. Thus, we focused our work on a few specific questions and topics, which were almost unknown in the countries in question. Even the accession negotiation with the European Union increased awareness about those topics among public administration and the general public. For example they are the partnership principle, evaluations, seven-year financial planning and even the scope of funding. The changes touched all stakeholders from public administration, private companies and non-governmental organizations. All stakeholders had to start learning how to cope with these principles. The text of this publication primarily targets small and medium enterprises and the civil society organizations. Public administration is seen as an implementation structure rather than as the final beneficiary of the Structural Funds assistance.

Many processes in public administration were centralized and activities connected to the partnership principle were unknown or even rejected. Worries concerning failure in financial absorption capacity pushed public administration forward to also apply these new elements. There were some successes and some failures. Both are discussed in this publication.

The publication is devoted primarily to the Visegrad countries (Poland, the Czech Republic, Slovakia and Hungary). The eastern part of Germany (the former GDR) was added to the research. East Germany became an EU member almost without any preparation. One element that unites the countries in question is their common experience with a totalitarian regime and the transition of the societies and their economies.

Particular chapters of the publication are sorted by topic. The first is about the Structural Funds assistance for innovation in Small and Medium Enterprises in Saxony in Germany. The following two texts deal with the issue of aid from EU Funds for small and medium enterprises in the Slovak Republic, specifically in the region of Banská Bystrica. The fourth chapter is a study of cross-border cooperation between small and medium-sized enterprises in the Czech Republic and Poland. Then there is a chapter dedicated to another of the issues that is beyond the scope of small and medium-sized enterprises as the fifth chapter is followed by lessons learnt from the 2007-2008 Action Plan of the North Hungary Operational Programme, with special regard to economic development. The next chapter is dedicated to the issue of nongovernmental organizations and the impact of Structural Funds in this sector. The sixth chapter is devoted to the topic of evaluating the impact of Structural Funds in the countries surveyed, and developing an evaluation culture. Then there is a final chapter devoted to the problems and positives aspects of implementing projects supported by the Structural Funds in the non-profit sector in the Visegrad countries.

We hope that the publication will help discussion about the future of the EU Cohesion Policy.





IMPACTS OF EU COHESION POLICY ON INNOVATION IN SMES IN EAST GERMANY WITH A SPECIAL FOCUS ON SAXONY

1.1 Historical development

In order to compare the promotion of SMEs and its impact in East Germany with Central European Countries (CEC), we must take into consideration several particularities of the entrepreneurial situation in East Germany, which are connected to the specific transition path of the region and which continue to have an effect today (chapter 1.2). Moreover, the innovation policy set up by the German government as part of its development strategy for the East German Länder (states) are discussed in the context of the overall promotion of the East German economy. Following reunification, East Germany has been an EC member since 1990 and has, as an Objective 1 – region, profited from EU Structural Funds. Nevertheless, EU promotion covered only a small part of the entire volume of subsidies for East Germany: The majority of the funds were, in fact, transferred from West Germany. Due to German and European resources often flowing into common programmes and enterprises profiting from different support programmes simultaneously, it is almost impossible to separate the effects of the various programmes. Hence, in an evaluation of the EU promotion for East Germany, the concomitance of an intensive, national promotion in addition to the EU one must be considered in order to avoid reaching false conclusions.

This is especially important when comparing the situation with new Member States, where EU funds provide the bulk of the total promotion for innovation (Licht, 2009, p.68). Chapter 1.3.2 reviews the impact of innovation support in East Germany. Ever since the convergence process, supported by high subsidies for innovation, which started in the early 1990s, there has been a high interest in investigating their efficient use and impact on innovation and growth.

The scheduling of the EU budgetary period 2007-2013 was another reason for deeper investigation so that this paper benefited from a number of existing impact analyses. As an example, Saxony has been analysed more closely with regard to the configuration of the economic promotion and, more specifically, the promotion of innovation in the entrepreneurial sector, as well as in research facilities, and the amount of the funds received. For an evaluation of the effects on the Saxony economy, we review the first general economic indicators. Then, we discuss the data and results of two extensive evaluations of the R&D promotion of the Free State of Saxony Ministry for Economy and Labour: first study by the Institute for Economic Research in Halle (Günther et al., 2008) and a second one by Konzack et al., 2007. Finally, the paper summarises the effects of the EU and non-EU-funded promotion of innovation in SMEs in East Germany and Saxony and draws conclusions for the future configuration of innovation policy and promotion instruments in transition countries.

1.2 Economic Transition and its Impact on the East German Enterprise Sector and the Innovation System

The transition of the East German economy started in March 1990 when the then existing large industrial conglomerates (Kombinate) were abolished. During the following privatisation process they were decartelised and subsequently sold mostly to West German or international investors or to the former management by Management Buy Out (MBO). The integration of Eastern Germany into the West German monetary system (July 1990) implied an explosion of costs (wages, raw materials, liabilities) and, at the same time, cut off the former trading partners in Eastern Europe as the relationship to their currencies quadrupled. Consequently, a large number of enterprises was competitively unviable and was closed by the privatisation agency. Simultaneously with privatisation, a dynamic founding process took place which engendered vast numbers of small enterprises. By 1994 privatisation had been completed. The East German economy had lost nearly two thirds of its former productive capacity and had completely changed the character of its enterprise sector: The structure, largely determined by huge conglomerates in 1990, had moved to a pattern where only a few large scale enterprises, mostly owned by external investors, existed alongside a vast number of small enterprises and a smaller number of medium-sized enterprises. Even today this pattern is still evident as the example of Saxony indicates (cf. Table 1.1).

Table 1.1 Enterprise sizes by employees* and number of employees in Saxony per June 30, 2007

1 to 4	5 to 9	10 to 19	20 to 49	50 to 99	100 to 199	200 to 499	500 and more	All-together
71,896	19,584	10,779	7,342	2,828	1,260	587	183	114,459

* insurable employments.

Source: Bundesagentur für Arbeit, Betriebsdatendatei 2007, cited from IAB-Betriebspanel, Länderbericht Sachsen 2009.

By 2008 enterprises founded before 1990 accounted for just 24 % of the total in Saxony (IAB-Betriebspanel, 2009, p. 12). Both groups, privatised and newly founded enterprises, underwent a sensational modernisation process in machinery, equipment, and products subsidised largely by the German government and, albeit to a smaller extent, by EU funds. While the market position of the large-scale enterprises was defined and secured by the international parent companies, the SMEs had and have to struggle for their existence.

The particular transition path affected the innovation system deeply: Since most external investors use their acquisitions in East Germany as production sites only, the operational R&D units of the purchased enterprises were dissolved in the majority of cases. The East German Academy of Sciences, which had been an important input generator for industrial research, was closed in 1991. In contrast, the 38 kombinat-owned autonomous industrial research institutions – which represented 20 % of the then GDR's R&D employees – were evaluated and transformed into self-reliant Ltd-s. However, within the scope of the Fraunhofer-Gesellschaft, a number of publicly financed industrial-related technology research institutes were founded in Eastern Germany to compensate these losses. At present, 23 of the 80 German Fraunhofer institutes are situated in East Germany, 14 of them in Saxony. So, as a result of the reunification process and the special privatisation

strategy, a massive downsizing of East German industrial research took place. The number of R&D employees in the East German economy declined from 86,000 in 1989 to about 43,000 in 1993 (cf. Table 1.7). Former relations between research and industry were cut and the industrial networks destroyed (Albach, 1993). In general the companies privatised by MBO had problems to finance their own research. West German or international investors abstained and still abstain nearly completely from doing research in their East German production sites but left and leave that task to their headquarters. In 2006 only 8.3 % of the internal R&D investments of the private sector in Germany (some 41 billion euro) were spent in the East German states (including Berlin), while Bavaria (23.8 %) and Baden-Württemberg (28.4 %) counted for more than half of the total internal R&D investments (BMBF, 2008, p. 83). For the newly founded SMEs, the main task in the early phase of the transition process was not innovation and the development of new products but survival at all costs. So, until the mid-1990s, imitation and adaptation of products and technologies existing in the market dominated (Günther et al., 2010, p. 7).

1.3 Innovation Policy for East Germany after 1990 and its Impact on the Economy

1.3.1 Innovation Policy and Promotion Instruments for East Germany: General overview on Strategies and Programmes

While other transition countries after 1990 tried to finance growth and modernisation through exports – export capacity was often strengthened through low wages and currency depreciation – in East Germany that was not an option. Caught between highly productive West European industries and low-wage industries in the East European neighbouring states, East German firms faced a dilemma in which rapid productivity gains, induced by increased investments in physical and knowledge (R&D) capital, seemed to be the only solution. Consequently, the federal government concentrated subsidies on those types of private investments. In practical terms, the promotion design represented a compromise between the expansion of the existing instruments of the federal economy in the East German states and the adoption of a series of special programmes for East Germany. Despite its low GDP East Germany never benefited from EU Cohesion Funds because the criterion, the national (i.e. total German) GDP was above 90 %. However, as an Objective 1-region, it profited and profits largely from other Structural Funds.

From 1990 on, the East German states benefited additionally from (West) German funds for structural investments and recovery. From 1990 to 1994 they benefited from some 82.2 billion euro in transfers by a special fund for German reunification (Fonds Deutsche Einheit). In 1995 the new Länder (including Berlin) were integrated in the federal fiscal transfer system and additionally benefited from federal funds of 20.6 billion DM per year up to 2004 (Solidarpakt I). In 2004 the third and probably the last special recovery programme for the East German states was adopted for the period from 2005 to 2019 (Solidarpakt II; some 156 billion euro). 105 billion euro (part I) are meant to meet the infrastructural and local requirements still existing, 51 billion euro (part II) are meant for special investment programmes, financial aid and other federal programmes. The support of EU structural funds amounting to 17.3 billion euro is included in this framework (SMF, 2008).

From 2005 to 2010 the Federal Recovery Programme provides 3.1 billion euro for the promotion of innovation, R&D and education in the new Länder. At the same time the Länder should benefit from 12.1 billion euro from EU structural funds (cf. Table 1.2). Both the federal and the EU programmes, combined with state and local efforts, are meant to foster innovation and R&D measures in the East German states. But one has to take into account that only a part of structural funds subsidies are exclusively reserved for this priority.

Table 1.2 Federal Recovery Programme – Part II funds 2005 to 2010 in million Euros

	2005	2006	2007*	2008*	2009*	2010*	2005-2010*
Economy	1,309	1,153	890	865	874	873	5,963
Traffic	882	604	643	633	633	651	4,076
Urban Development and Housing	903	591	647	509	476	471	3,597
Innovation, R&D, Education	431	454	525	553	567	566	3,094
EU Structural Funds	2,230	2,239	1,898	1,915	1,927	1,929	12,138
Others	49	51	49	37	30	17	234
Total	5,803	5,092	4,651	4,542	4,506	4,507	29,102

* Financial planning.

Source: SMF 2008.

Recently, in addition to classic research policy on the one hand, and economic policy on the other hand, the overlapping areas of market-oriented research promotion and the support of business formation in innovative sectors have been in focus. This new approach demands a high coherence of the programmes of different administrative levels as well as of different policy areas, especially between the ERDF and ESF.

Given the predominance of SMEs in Eastern Germany, more or less all programmes for the Eastern Länder benefited the SME sector. Nevertheless, a great number of the programmes were explicitly created for SMEs. Indeed, it has to be pointed out that the German SME definition varies from the EU definition, including additionally enterprises from 250 up to 499 employees (cf. Table 1.3).

Table 1.3 SME Definitions in EU and in Germany

	European Commission					Germany		
Enterprise category	Headcount: Annual work unit (AWU)		Annual turnover (million euro)		Annual balance sheet total (million euro)	Headcount: Annual work unit (AWU)		Annual turnover (million euro)
Micro	< 10	and	≤ 2	or	≤ 2			
Small	< 50	and	≤ 10	or	≤ 10	< 10	or	≤ 1
Medium-sized	< 250	and	≤ 50	or	≤ 43	< 500	or	≤ 50
Large	≥ 250	and	> 50	or	> 43	≥ 500	or	> 50

Sources: EU Commission Recommendation 2003/361/EC (06.05.2003; effect of 01.01.2005).

Besides general economic promotion, by 1990 special efforts to foster innovation had already begun. The existing federal programme *Industrielle Gemeinschaftsforschung*, a classical programme to foster forward research for SMEs (Vorlauftforschung), was enlarged immediately to the Eastern part of the country as well as the contract research programme. Special instruments at that time were issued to stabilise the downsizing R&D sector: Mainly this comprised of a programme to subsidise R&D employees (*Personalförderung Ost* – PFO) and a second one which supported technology-oriented enterprise foundations (*Technologieorientierte Unternehmensgründung* – TOU). In a second phase, starting from the mid-1990s – in conformity with new German and European paradigms – project promotion and specifically promotion of cooperation became prevalent. One of the most important programmes adopted was the Federal programme PRO INNO (1999-2003). In the mid-1990s, Germany had a pioneering role in the development of a regional and cluster-oriented innovation and technology policy. The idea of a regionally-oriented innovation policy including an industrial cluster policy came up in that context. The aim was to promote the innovation potential not only of local initiatives but of whole regions. Within the programme *Unternehmen Region* (Entrepreneurial Regions), the Federal Ministry of Education and Research (BMBF) started a number of special programmes exclusively designed for the East German states including *InnoRegio* (1999-2006: 500 million DM), *Innovative Wachstumskerne* (Innovative Growth Cores; since 2001: 163 million euro), *Innovationsforen* (Innovation Forum; since 2001) and *Zentren für Innovationskompetenz* (Centres for Innovation Competence; since 2002). This shift to regionally-oriented promotion went along with a new placing practice, i.e. competition between applicants instead of placing per proposal (Gunther et al., 2010, p. 31). During the third phase, which started around 2001, the innovation policy developed the promotion of networking as a new instrument. At this time, the promotion of networking represents a substantial part of the entire German innovation policy together with the promotion of single and coordinated projects (Verbundprojekte).

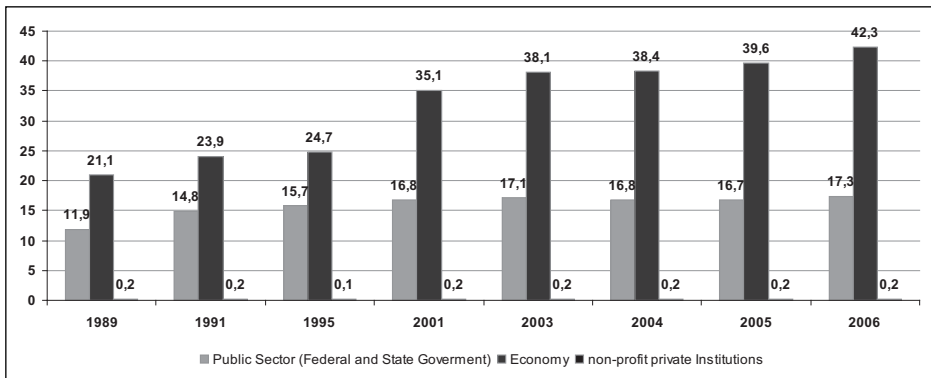
Some of the programmes that had initially been launched by the BMBF for East Germany, such as *Netzwerkmanagement Ost* (NEMO, 2002-2008) which subsidised managers for existing industrial networks over a period of four years in a degressive scale, were even enlarged to the West of the country and transferred into *Zentrales Innovationsprogramm Mittelstand* (ZIM, 2008-2013: some 310 million euro per year). The ZIM programme should encourage the SMEs to invest more in the sector of market-oriented R&D and to reduce the technical and economic risks of R&D projects. The focus here is on innovation support and consulting services. The INNO-KOM-Ost programme should help to improve the conditions for continuous industrial R&D and increase the technological efficiency as well as their competitiveness. Another explicit aim is the compensation for competitive disadvantages that are a result of the East German transition problems. With this intention the initiative for *Spitzenforschung und Innovation in den Neuen Ländern* (Top-level Research and Innovation in the New Federal States) encourages the profiling of universities and non-university research facilities in the East German states. The objective is to strengthen the innovation capacity of the region, which should be achieved through the undertaking of research and development in the area, as well as by promoting young talent, training academic personnel and likewise equipment and training investments. The collaborations, which should also include the companies, have to be conducted by a university or by a research institution. Eventually, SMEs and start-ups can rely on the SME Patent Action. This will increase qualified patent applications as well as achieving an optimized utilization

of patents. Up to 50 % of the external benefits could be subsidized as part of the patent application. **PRO INNO II** (2004-2008), promoting the increase of the innovation capabilities for SMEs, with the emphasis on the development of innovative products, technical services or processes. A special feature was, in that case, that there were no restrictions on using only certain technologies. Greater importance and priority was given to the cooperation between companies and/or research facilities. Support ranges from cooperation projects between companies, to cooperation projects of one company with a research institution, to the exchange of R&D employees.

Two additional programmes for the Eastern states were issued within the existing programme *Unternehmen Region: InnoProfile* (2007-2013, 140 million euro) which fostered cooperation between public research institutions and technology-intensive firms in East German regions by subsidising young R&D research groups over a period of 5 years, and *ForMaT* (*Forschung für den Markt im Team* – Research for the Market in Teams; 2007-2012, 45 million euro) that sought to promote collaboration between technology-oriented and business-oriented researchers in a joint team to develop concrete innovative projects. Recently the number of promotion programmes for the East German economy has been in decline, albeit the latter is, compared to the West German one, still in a huge backlog (Günther et al., 2010, p. 32).

In 2006 Germany spent 59.8 billion euro on R&D. The major share of this spending is covered by the economic sector itself (cf. Graph 1.1).

Graph 1.1 Contributors to German R&D expenditure by sector in billion euros (1989-2006)



Source: BMBF, 2008, p. 11.

Since the private sector investments on R&D in the Eastern German states are less intense than in the Western states, in 2006 only 13.1 % of the total German R&D was spent in Eastern Germany including Berlin, 3.4 % in Saxony (BMBF, 2008, p. 11-1311). To compensate for this backlog the federal government spent nearly one quarter of its total R&D funds in the Eastern German states over the last decade (1.96 billion euro out of 8.86 billion euro in 2000 and 2.22 billion euro out of 10.14 billion euro in 2006) which was a slight increase compared with the mid-1990s, since the share was 23.8 % in 1995. The Eastern German states (including Berlin) had a share of 24 % out of the 8 bil-

lion euro R&D budget of all German states in 2006. Saxony counted for 526 million euro or 6.6 % of the total budget. Besides the city states of Berlin, Hamburg and Bremen, Saxony had the highest budget on R&D per capita (some 120 euro) that year. The total expenditure on science for R&D, including R&D expenditure on education and academic teaching in Germany, was 76 billion euro in 2006. The public sector counted for around 44 % and the private sector for 56 % of this amount. It rose by 43 % from 53.3 billion euro in 1995 to 75.96 billion euro in 2006 (BMBF, 2008, p. 41-43, 48/49, 68).

Table 1.4 Total R&D expenditure by state and regional share of GDP (2006-2008)

State	Expenditure on Research and Development million euro			Share of GDP in %		
	2006	2007	2008	2006	2007	2008
Baden-Württemberg	14,452	15,676	16,854	4.25	4.38	4.62
Bayern	12,213	12,212	13,197	2.96	2.82	2.97
Berlin	3,168	2,865	3,130	3.88	3.38	3.53
Brandenburg	620	651	720	1.22	1.22	1.33
Mecklenburg- W. P.	460	456	520	1.4	1.31	1.46
Saxony	2,037	2,406	2,622	2.29	2.59	2.76
Saxony-Anhalt	584	588	607	1.19	1.14	1.13
Thuringia	844	880	961	1.81	1.81	1.91
Germany	58,779	61,482	66,532	2.53	2.53	2.67

Source: Destatis 2010.

Table 1.5 State's R&D expenditure by Länder, regional share of GDP and capita and amount of ERDF-R&D Funds in 2007

State	2007			
	million euro	share of state's GDP in %	per capita	EFRE - R&D Funds in million euro
Baden-Württemberg	1,132	0.32	105	0
Bayern	1,346	0.31	108	0
Berlin	541	0.64	158	25
Brandenburg	180	0.34	71	0
Mecklenburg- W. P.	137	0.39	82	25
Saxony	526	0.57	125	119
Saxony-Anhalt	227	0.44	94	34
Thuringia	226	0.47	99	15
Germany/ average	8,037	0.33	98	218

Source: Destatis 2010, BMBF 2009, GWK 2009.

The German innovation support system is so complex that not only applicants but even researches can hardly get a complete view of it. There is no statistical data on the joint volume of all support programmes at the different administrative levels.

A consequence of the high funding volume is a remarkably high ratio of funded enterprises in East Germany: According to estimates by Legler et al. for 2000, every third industrial enterprise in East Germany and every eighth enterprise in business services has been awarded public assistance for research (in West Germany: every tenth industrial enterprise and every twelfth business service provider; Legler et al., 2004, p. 21). Other calculations state that about two thirds of R&D expenditure in East Germany has been mobilised by public support. As many as 90 % of the manufacturing enterprises engaged in R&D received financial support for R&D while just one third of these enterprises did so in West Germany (Czarnitzki and Licht 2004, p. 4). But even then, Germany as a whole (2.54 %) and all East German states (from 1.14 % to 2.59 %) missed the Lisbon goal of a R&D expenditure of 3 % in 2007 (Stifterverband, 2010).

1.3.2 Impacts of Economic Promotion on Innovation of East German Enterprises

After almost 20 years of intensive funding the general figures for the East German innovation performance indicate that there is still a gap compared to West Germany, even if we can notice remarkable progress in R&D expenditure per capita and GDP (cf. Table 1.6, Table 1.7). In the following chapter we evaluate the impact of promotion programmes on innovation in East Germany at first more generally, i.e. by data on the development of innovation performance, patents, and productivity.

The share of R&D expenditure in the economic sector in GDP for 2007 ranges from 0.32 % in Brandenburg to 1.07 % in Saxony, while the total amount for Germany was 1.78 %. In Thuringia and Brandenburg the share was actually sinking between 2003 and 2007. By contrast the number of employees in R&D has increased overall (cf. Table 1.6).

Table 1.6 R&D expenditure in the economic sector 2003-2007:
share of GDP and R&D employees in East German states

	R&D share of GDP			R&D employees in 1,000		
	2003	2005	2007	2003	2005	2007
Brandenburg	0.34	0.29	0.32	1.6	1.6	2.1
Meckl.- W. P.	0.26	0.30	0.38	0.9	0.5	1.3
Saxony	1.02	1.07	1.34	9.2	9.4	1.2
Saxony-Anh.	0.28	0.34	0.34	1.7	2.0	2.2
Thuringia	0.98	0.95	0.93	4.7	4.9	5.1
Germany	1.76	1.72	1.78	298.0	304.5	321.9

Source: Stifterverband Wissenschaftsstatistik 2010c.

The number of R&D employees in the East German economy continued to shrink after the decline and bottomed out after 2003 at about 30,000 only.

Table 1.7 R&D employees* in the East and West German economy 1989-2007

Germ	1989	1991	1993	1995	1997	1998	2001	2003	2005	2007
East**	86,000	42,880	31,997	32,611	35,725	35,546	36,903	30,463	29,525	31,509
West	296,509	278,877	261,777	250,704	250,545	271,148	270,354	267,610	274,978	290,344

* R&D employees in R&D units of the enterprises and in joint research institutions.

** East Germany: 1989 without West Berlin, from 1991 West Berlin included.

Source: IWH, cited from Günther et al (2008)

The number for patent applications shows unstable growth in all East German states and even a decline in Berlin and Saxony (cf. Table 1.8).

Table 1.8 Absolute Growth of patent applications in East German states 1995-2007

Federal state	1995	2000	2005	2006	2007
Berlin	1,345	1,265	866	943	992
Brandenburg	239	396	311	428	389
Meckl. - W. P.	153	212	197	183	170
Saxony	882	1,021	847	810	923
Saxony-Anhalt	354	466	366	343	327
Thuringia	488	762	703	346	598
East Germany*	2,116	2,857	2,424	2,110	2,407
Germany	38,377	53,521	48,367	48,012	47,853

* Without Berlin because separation of data for East and West Berlin is not possible.

Source: Deutsches Patentamt, cited from BMBF 2008.

A distinct growth can be stated for the number of patent applications per inhabitant and the number of patent applications of the economic sector per employee which in some cases doubled during the decade from 1995 to 2005 and even tripled. However it was far from reaching the nationwide level of 139, not to speak of the leading state Baden-Württemberg's 291 in 2005 (cf. Table 1.9).

Table 1.9 Patent applications in East German states per 100,000 inhabitants and patent applications of the economic sector per 100,000 employees 1995-2005

Federal state	all patent applications per 100,000 inhabitants			patent applications of the economic sector per 100,000 employees		
	1995	2000	2005	1995	2000	2005
Berlin	27.6	34.5	32.4	44.7	65.4	77.2
Brandenburg	8.0	15.9	16.8	11.8	25.0	35.7
Meckl. - W. P.	5.3	10.5	11.5	7.1	10.3	18.0
Saxony	16.7	22.7	28.7	25.9	37.3	60.4
Saxony - Anhalt	8.7	13.3	12.2	15.1	18.4	25.8
Thuringia	12.9	21.4	28.3	20.9	32.5	55.2
East Germany*	10.2	16.7	19.5	16.2	24.7	39.0
Germany	36.4	49.2	54.1	77.4	111.3	139.1

* Without Berlin because separation of data for East and West Berlin is not possible.

Source: Patentatlas Deutschland, 2006.

An important outcome of East German data is the much lower share of patent applications of the economic sector in overall applications. While in Germany as a whole this ratio amounted to 83.5 % (Baden-Württemberg: 88.5 %) in 2005, it was just 65.7 % in Eastern Germany (without Berlin). One can, however, discern a dynamic growth in the East, for this ratio had only been at 50.7 % in 1995 (Patentatlas Deutschland, 2006, p. 138). Moreover, Legler et al. pointed out that the focus of the East German patents was in high-tech branches (except for computer technology) which should be a competitive advantage in the middle and long term perspective (Legler et al., 2004, p. 53). Another result was that despite the rather high innovation intensity the innovation effects in East Germany lagged far behind the Western level. The share of enterprises with product innovations was lower and the share of cost savings by process innovations was even distinctly lower than in West Germany (cf. Table 1.10, Graph 1.2). Indeed, regarding these data it should be considered that the effects of innovation processes lag behind the funding period necessarily.

Table 1.10 Share of enterprises with product innovations in East and West Germany, mid 1996-2007 (in %)

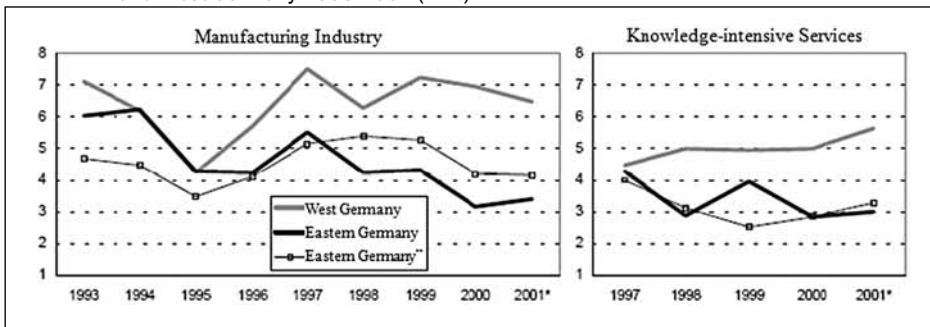
	Share of enterprises with product innovations				
	mid 1996 – mid 1998	mid 1999 – mid 2001	mid 2002 – mid 2004	mid 2005 – mid 2007	2007*
East Germany	34	28	25	36	31
West Germany	33	27	27	40	39

* The surveys in 1998, 2001, 2004 and 2007 asked for product innovations during the last two years.

The survey in 2008 asked for product innovations during the year 2007 (January-December).

Source: IAB-Betriebspanel, Länderbericht Sachsen 2009.

Graph 1.2 Share of cost savings by process innovations in East and West Germany 1993-2001 (in %)



Knowledge-intensive services: without banking and insurance

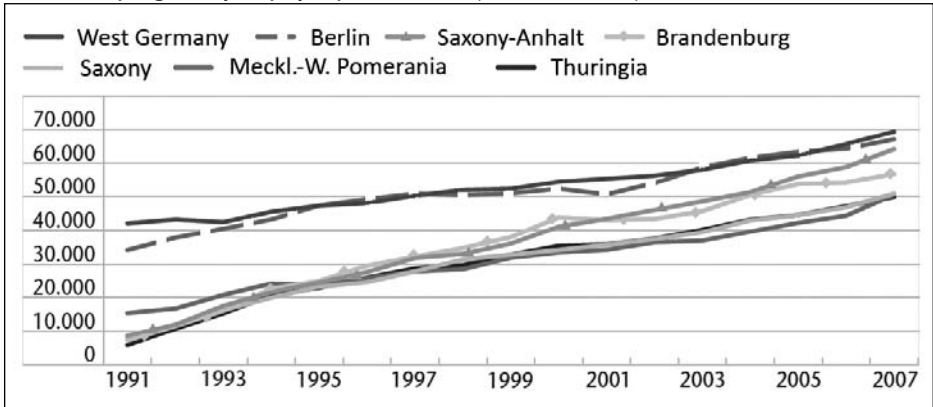
* preliminary

** expected value when identical behaviour of East German enterprises as Western in same branches and size structures

Source: Mannheimer Innovationspanel, cited from Legler, 2004, p. 57.

A more general indicator of successful innovation processes is productivity growth. It shows that the gross value added in the East German manufacturing sector per gainfully employed person grew steadily in all Eastern states between 1991 and 2007.

Graph 1.3 Gross value added in the manufacturing sector 1991-2007
per gainfully employed person in EUR (nominal amount)



Source: Volkswirtschaftliche Gesamtrechnung, Institut der deutschen Wirtschaft Köln (Röhl, 2009).

In their thorough analysis of East German innovation Czarnitzki and Licht discerned, besides the general lack of innovation compared to West Germany, certain structural distinctions, owing partly to the difficult start, partly to the high subsidies: The share of enterprises systematically pursuing R&D in the East German states amounted to 27 % in 2000 and thus was higher than in Germany overall (23 %). While nationwide more than 80 % of the R&D employees were engaged in large enterprises and just 20 % in SME, in East Germany 60 % of them are engaged in SMEs. Whereas 90 % of the German R&D personnel were engaged in manufacturing, this percentage was only 70 % in East Germany. Nearly all enterprises systematically pursuing R&D in East Germany, namely 90 %, received public assistance, while just 33 % in West Germany did (Czarnitzki and Licht, 2004, p. 4).

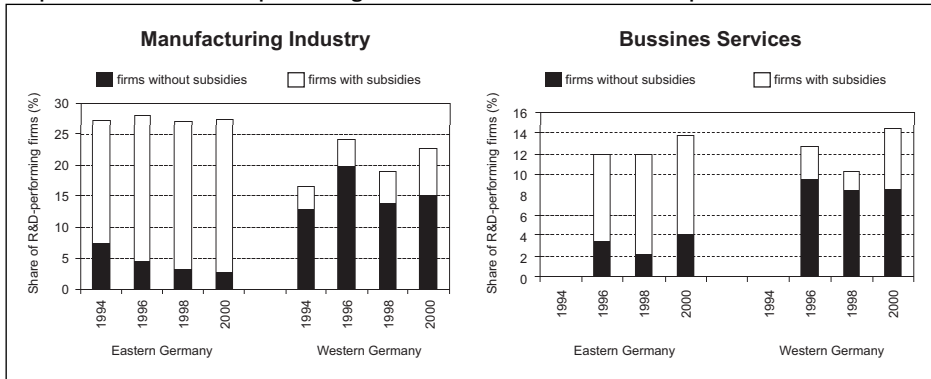
Against this background, Czarnitzki and Licht examined the effectiveness and efficiency of public R&D supports for private sector projects. The analysis was restricted to programmes that involved a direct payment to private firms. Indeed, they have not evaluated single programmes but the “average” impact of public R&D subsidies. The authors examined the link between R&D (which was both publicly as well as privately funded) and innovation output during the first ten years of the transition process in Eastern Germany, based on the data of the Mannheim Innovation panel.¹ As a measure of innovation output patents were used. The relation between publicly funded R&D and innovation input and output in Western Germany was used as a benchmark for the impacts of the R&D programmes in the East.

Czarnitzki and Licht’s econometric estimates revealed positive effects, those being that public funds do not substitute for a firm’s own resources but they stimulate innovation input. The differences with regard to innovation were statistically highly significant.

¹ Since 1993 the Centre for European Economic Research (ZEW) in co-operation with ifmas (Institute of Applied Social Science) annually gathers data, with regard to the innovation behaviour of the German economy. The survey covers the areas of mining, manufacturing, energy, construction, producer services and distributive services. The sponsor is the BMBF. The survey is representative of Germany. It is designed as a panel survey. Thereby, the same enterprises are included every year. Every two years the sample is refreshed by a random sample of newly founded firms in order to substitute enterprises which are closing or have left the market through mergers.

Both R&D intensity and innovation intensity were considerably higher when firms received grants. The estimations indicated that a significant share of Eastern German firms would not be engaged in R&D without public support, a finding that may hint at limited access to alternative sources of finance for the SMEs. The low share of R&D expenditure without public R&D subsidies in the region illustrates these difficulties (cf. Graph 1.4).

Graph 1.4 Share of firms performing continuous R&D with and without public R&D subsidies



Annotation: Graphs refer to firms with five or more employees.

Source: Czarnitzki/Licht 2006.

The analysis of firms' patent activities showed that they were affected positively by support-induced R&D in both German regions. Regarding the likelihood of applications for at least one patent and the number of patent applications, Licht and Czarnitzki did not find clear evidence that R&D induced by public funds was less productive than R&D financed solely on the firm's own account.

Altogether, the researchers attribute a positive role to R&D promotion in the transition process. Without public promotion of innovation, fewer firms would have been able to implement new products and processes in national and international markets. Indeed, the results point towards a lower marginal patent productivity in Eastern Germany but, as it was stated for both publicly and privately-funded R&D, this must not necessarily be linked to public funding. The authors thus concluded that there are strong arguments for continuing such support. However, some of their results may prompt questions. For instance, the declining share of firms performing continuous R&D without public R&D subsidies between 1994 and 2000 might indicate deadweight-effects² (cf. Graph 1.4).

In fact, other authors come to a more critical assessment of the impacts of innovation promotion in Eastern Germany: Rammer et al. analysed the innovation performance of the German economy between 1993 and 2003, also drawing upon data from the Mannheim Innovation Panel. They stated that, after a sharp decline in 2002, the innovation success in the East in 2003 was noticeably lower than in West Germany. The ratio of turnover with market innovations in manufacturing was 4.5 % compared to 7.5 % in the West. Cost savings with process innovations in manufacturing amounted to 3 % while in West German enterprises it amounted to 4.5 %. At least the growth perspective in the East was positive (Rammer, 2005, p. 13).

² Deadweight effect means that R&D activities might have occurred even without the use of the public support.

One reason for the lower innovation success and also for the minor role of private research in the East was assessed in the lack of large-scale enterprises and the large extent of “external” control through West German or international owners in the East German economy: Generally, large enterprises not only contribute most to R&D expenditures in a national economy, but they act as anchors for innovation networks and research cooperation projects in which SMEs participate. Cooperation with large companies is evidently also of great importance for market success, particularly in the worldwide marketing of new products. As stated earlier, the majority of East German enterprises were founded after 1990 and so on the whole have not yet reached the scale of operation (Irsch, 2005, p. 11). Thus, East German firms currently lack suitable industrial cooperation partners that provide them access to these networks, all the more so because the small number of existing large-scale enterprises mostly controlled by external investors abstain nearly completely from doing research and drop out as cooperation partners.

Overall, the recommendation of almost all researchers has been to continue the current promotion of innovation in East Germany. But they also advise to focus more closely on the deficits, for instance, by stepping up the technology transfer from research institutes to industry and thus dovetailing science and the private sector more closely, setting up regional spin-off funds and increasing the absorption capacity for R&D results in existing East German enterprises (Czarnitzki and Licht, 2006; Irsch, 2005, p. 15).

1.4 The Case of Saxony

1.4.1 EU and Regional Economic Innovation Promotion in Saxony

From 1999 to 2006 Saxony gained some 4.8 billion EUR of support from European Structural Funds. The ERDF took the major stake of around 3 billion EUR, while the ESF and the EAGGF stood for 1.1 billion EUR and 0.7 billion EUR respectively. On 5 July 2007, the European Commission approved the operational programme for Saxony covering the period 2007-2013 (SMWA, 2007a). This programme constitutes European Union funding for Saxony (ERDF) under the “convergence” objective, including the NUTS-II-Region Leipzig qualifying for transitional assistance (“phasing out”). The overall budget of the programme comprises of some 4,124 million EUR, EU assistance from the ERDF amounts to approximately 3,091 million EUR (roughly 11.74 % of all the EU funding invested in Germany under cohesion policies over the period 2007-2013). The EU funding up to 75 % requires additional state or national funds (22 to 25 %) and efforts by the private sector (0 to 3 %). The first of the five programme’s priority axes is “Strengthening innovation, science and research”. This priority axis calls for the structures of the economy to focus on knowledge based fields by fostering the innovative skills of enterprises in Saxony and the expansion of research and science facilities. More specifically, this is to be achieved through the funding of single-company R&D projects, joint R&D projects, technology transfer, providing risk capital

for new technology companies, applied research projects and infrastructure, university infrastructure, E-Business in SMEs and E-Government. The EU Contribution for priority axis 1 in the funding period 2007-2013 is set to be 1,079 million EUR, Saxony public contribution: 319 million EUR, so that the total public contribution is 1,398 million EUR (cf. European Commission, Regional Policy, Development programmes). Also the priority axes 2 “Advancement of education facilities and infrastructure” and 3 “Promotion of the competitiveness of the industrial economy” are adequate to promote innovation and technological progress directly and indirectly. These axes count for 236 million EUR and 587 million EUR respectively. They stand for 8 % and 19 % of the ERDF funds, while the major stake is priority axis 1 with 35 %. Compared with the period 1999-2006 this is a sharp increase by nearly 40 %, while technical infrastructure investment is shrinking.

The ESF Operational Programme for Saxony (SMWA, 2007b) was adopted in July 2007. The EU contribution in the funding period 2007-2013 is planned to be 872 million EUR, national public contribution: 285 million EUR, so that the total funding is 1,157 million EUR (cf. European Commission, Regional Policy, Development programmes).

In two of its four priority axes (Human capital; Transnational instruments) special support for innovation is projected. Since the Human Capital-axis counts for more than 40 % of the overall budget (around 368 million EUR) the ESF funding also lays a strong emphasis on innovation promotion.

A future challenge in Saxony (and East Germany as a whole) will be the lack of highly qualified personnel. SMEs especially will face enormous difficulties to secure personnel for future innovations. Saxony therefore developed a number of support instruments within the ESF to meet this challenge. Innovation is supported in the following fields: Founding of innovative enterprises by university graduates; Ph.D. Thesis in manufacturing; Innovative Ph.D. Thesis; Reconciling career and family life; Joint Ph.D. Thesis; Networking of mentors; Junior research groups; Competence schools; Research networks; Qualification of instructors; Adapting qualifications; Career Services; Innovative development projects.

In 2009 the ESF funds were mainly used to support SME projects (60 %, for example: advanced training, employment promotion, social services, support for young professionals) and financial assistance for vocational training (31 %). Micro loans and support for hiring and start-ups complete the range of ESF funding instruments (SAB, 2009, p. 21-26).

The Development Bank of Saxony (SAB, Sächsische Aufbaubank), the central development agency of the Free State of Saxony, facilitates the sharing and bundling of resources between EU, national and regional development and support programmes, aimed mainly, but by no means exclusively, at SMEs. SAB also provides entrepreneurs with start-up advice, business coaching and marketing assistance. SAB targets so-called future-oriented companies by supporting investment in research and development and intellectual property. Funding takes the form of grants, subsidies, loans and guarantees.

The Free State of Saxony implemented the lessons learned from an earlier evaluation of the EU, federal and Saxon support programmes from about 2005. The current

programmes show the shift to a more intense promotion of innovation potential itself as it has been made by the design of the ERDF and ESF operational programmes for 2007-2013. Whereas some of the existing R&D programmes focussing on projects had been prolonged, others, such as the *Technologietransferförderung* (Promotion of Technology Transfer), started with the beginning of the financial period.

The current innovation programmes are as follows:

Einzelbetriebliche FuE-Projektförderung (Individual R&D Projects). Research projects based on future-oriented technology fields and intending to develop new products and processes are supported. A product or process is considered new if it has not been economically employed in the European Union. Process and product developments are also eligible here. The programme is funded by EU structural funds (ERDF) and Saxony subsidies. For 2006-2010 subsidies of around 281 million EUR are planned.

In addition to individual R&D projects, Saxony supports the *FuE-Verbundförderung* (R&D Joint Projects). For these projects, which are carried out jointly by several companies or by enterprises and research facilities, the same criteria are applied as for the individual R&D projects. The maximum grant levels are graded according to industrial research and experimental/ pre-competitive research and to participating companies. Here SMEs are clearly favoured. Both programme schemes started in 1998 and have their legal basis up to 2015. They too are funded by EU and state funds, 353 million EUR being available for this priority in the period 2006-2010.

The respective share of public subsidies in both programmes is given in Table 1.11.

Table 1.11 Share of public subsidies in individual or joint R&D promotion programmes in Saxony, 2007-2013 (maximum in %)

	Individual R&D Projects	
	Industrial Research	Experimental Research
Small-sized enterprises	65	40
Medium-sized enterprises	60	35
Other enterprises	45	20
	R&D joint promotion	
	Industrial Research	Pre-market Research
SMEs	70	45
Other enterprises	55	30
Non-profit organizations	100	100

Source: SMWK, 2010.

Furthermore, Saxony supports the payroll costs for *Innovationsassistenten* (Innovation Assistants) for companies with up to 500 employees. The programme will also support the employment of graduates and academics with technical or scientific education from universities and colleges as well as research institutions to work on projects with technology-oriented content. In addition to the project's context, particularly the innovation policy of the respective companies, there is an eligibility criterion. Besides reducing the

risks, the recruitment of highly qualified personnel should be incentivised. This support is especially interesting for SMEs because of the acquisition of up to 50 % of the costs for personnel as the main share of R&D expenditure. The programme is financed by EU funds (ESF) only. For the period of 2007 to 2010 it is endowed with 8.5 million EUR. Alongside the Innovation Assistants in the SMEs, they will also be supported as users of innovative technologies.

The *Technologietransferförderung* (Promotion of Technology Transfer) supports products already developed or the innovation of the processes, directly from the technology provider to one or more technology receivers, primarily in the sector of future technologies. The programme is thereby interesting both for technology providers and receivers, and it should specifically strengthen the transfer of technological innovations from Saxon research institutions to Saxon SMEs. From 2007 to 2010 the programme can allocate 39.4 million EUR. The respective share of public subsidies in the programme is indicated in Table 1.12.

Table 1.12 Share of public subsidies for the promotion of technology transfer projects (max., in %)

	Technology Transfer Promotion	
	non-monetary and capital investments	External Consulting
Medium-sized enterprises	40	75
Small-sized enterprises	50	

Source: SMWA, 2009.

The programme started in 2009 and continues up to 2013.

In addition to the mostly application-oriented R&R projects, Saxony also supports *Markteinführung innovativer Projekte* (Market Launch of Innovative Projects) within the programme *Mittelstandsförderung* (Promotion of SMEs). Thereby SMEs will be granted financial support up to 50 % of the eligible costs (max. 100,000 EUR), when they open up new markets for innovative or improved products, services or production processes. This should strengthen the sales in the domestic and export market as well as the competitiveness of the companies. Similarly oriented is the programme *Produktdesign* (Product Design). SMEs should be assisted in exploiting the potential of industrial design in order to optimize their sales opportunities at home and abroad. These will be funded with grants covering between 30 % and 50 % of the costs.

1.4.2 Impact on Innovation in the SME Sector

Our representation of the impact of Saxon R&D promotion is based mainly on two extensive studies. The study by Günther et al. (2008) is an ex-post analysis which is more or less based on the analysis of data gathered from plants supported by financial aid provided by the SAB between 2000 and 2006. The analysis data was obtained from telephone-based interviews and case studies.³ The aim of the survey was to evaluate the three R&D programmes in Saxony, to assess the medium- to long-term effects of the support, and to gain scientifically-based recommendations for its organisation and im-

³ From the methodological perspective a survey-based evaluation has to take in account distortive answering.

provement as ordered by the Saxon Ministry for Economic Affairs and Labour. The other investigation, also ordered by this Ministry, was realised by Konzack et al. (2007) and analysed all R&D-pursuing enterprises in Saxony during 2005 and 2006 with the focus on continuous R&D activities. Both studies included SMEs and large enterprises as well, but with a focus on SMEs. At first, we discuss some general data on the R&D performance. **R&D expenditure** in the economic sector in Saxony during the period 2003-2006 rose steadily (cf. Table 1.13).

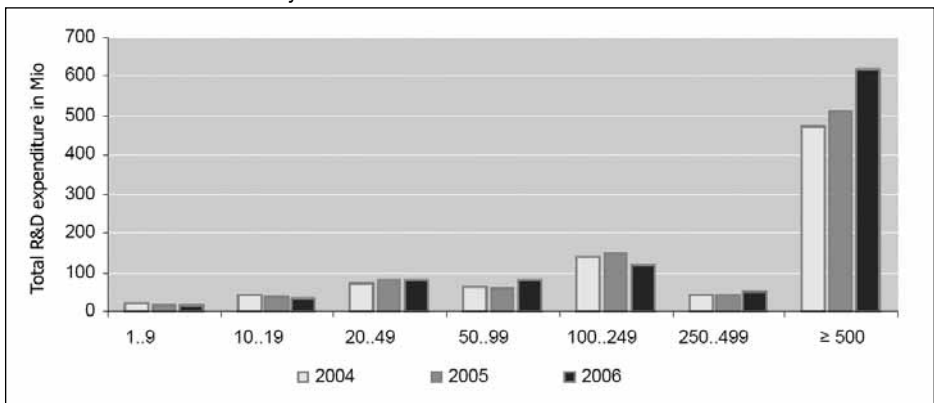
Table 1.13 R&D expenditure in the economic sector in Saxony 2003-2006 (in million EUR)

	2003	2004	2005	2006
Saxony	848	861	915	974

Source: BMWF, 2008.

In 2006, 33 % of total R&D expenditure was spent by SMEs and 67 % by large enterprises. Graph 1.5 shows that during 2004-2006 the R&D expenditure of SMEs remained static or even shrank while that of the large enterprises expanded considerably. Konzack et al. (2007) therefore presume a concentration process of R&D towards large enterprises.

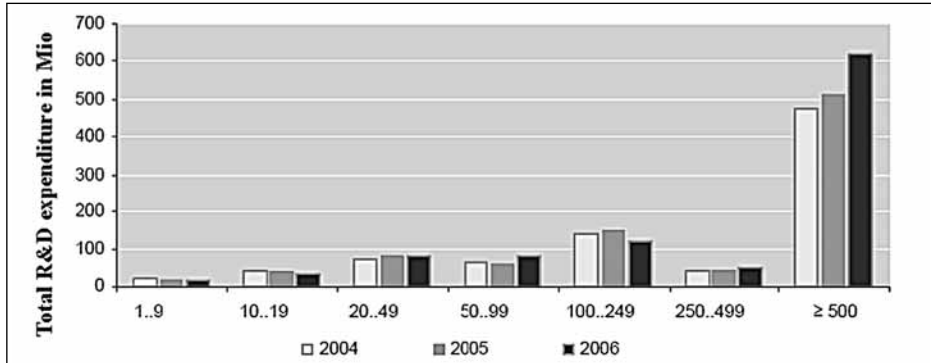
Graph 1.5 Total R&D expenditure of Saxon enterprises performing continuous R&D by size structure in 2004-2006



Source: Konzack et al. 2007:36.

In 2006, about 950 R&D-pursuing firms existed in Saxony, about 75 % of which undertook continuous R&D activities. 90 % of the firms with continuous R&D activities applied for public R&D support programmes, while 40 % of them made use of R&D support programmes from the state of Saxony. The focus of the Saxon R&D support was on SMEs, where the funding amounted to 39.7 % of total R&D expenditure compared to 16.7 % for all supported enterprises (cf. Graph 1.6). This concentration on SMEs is in accordance with the fact that about 95 % of the enterprises with continuous R&D activities are SMEs (Konzack et al., 2007, p. 40).

Graph 1.6 Share of R&D support in total R&D expenditure of supported enterprises with continuous R&D in 2006



Source: Konzack et al., 2007.

After the sharp decline in the early 1990s the **number of R&D employees** in the Saxon economy grew steadily until 2007 with a recess in the years 2001-2003 (cf. Table 1.14).

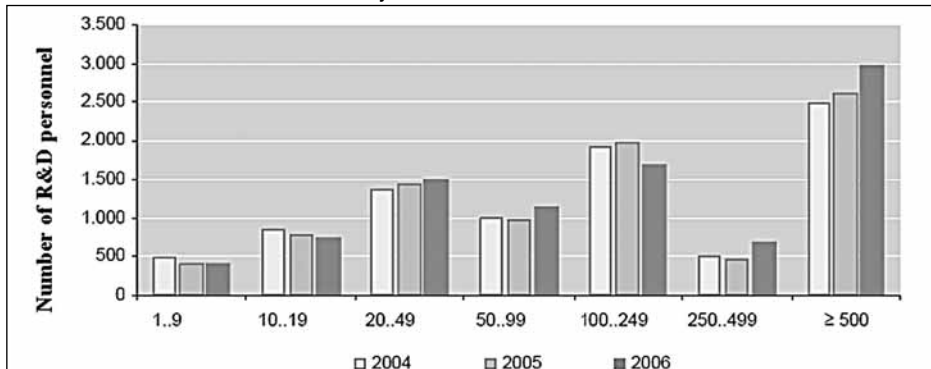
Table 1.14 R&D employees in the Saxon economy 1991-2007

	1991	1993	1995	1997	1999	2001	2003	2005	2007
Saxony	13,427	8,754	9,891	11,438	11,496	11,057	9,211	9,393	11,208

Source: Stifterverband, 2010b.

R&D personnel in enterprises performing continuous R&D activities followed this pattern. However, since 2002/2003 we can observe a concentration process characterised by the marginalisation of non-continuous R&D and a growing share of R&D personnel in larger enterprises (Konzack et al., 2007, p. 25, cf. Graph 1.7). The latter development might be induced by the termination of the R&D programme PFO in 2003, and also by a general decline of the number of SMEs.

Graph 1.7 Growth of R&D personnel in Saxon enterprises with continuous R&D activities by size structure



Source: Konzack et al., 2007, p. 27.

Despite the concentration process the average number of R&D employees in enterprises with continuous R&D activities between 2004 and 2006 has risen in nearly all size groups (cf. Table 1.15).

Table 1.15 Average number of R&D employees in enterprises with continues R&D activities by size structure

	2004	2006
1 - 9	2,7	2,9
10 - 19	5,5	4,9
20 - 49	7,4	8,4
50 - 99	11,6	12,0
100 - 249	22,8	23,7
SME	8,2	8,6
250 - 499	20,0	26,3
from 500	155,6	156,4
Total	11,8	13,4

Source: Konzack et al., 2007.

The positive development of **patent applications** in Saxony is an indicator for successful R&D activities (cf. Table 1.16).

Table 1.16 Patent applications in Saxony 2000-2005

	2000	2001	2002	2003	2004	2005
All patent applications[*] (absolute number)	1,023.6	1,121.0	1,200.8	1,220.8	1,211.7	1,247.0
patent applications economic sector (absolute number)	595.9	684.5	777.5	857.7	839.4	872.6
All patent applications (index 2000=100)	100.0	109.5	117.3	119.3	118.4	121.8
Economic sector (index 2000=100)	114.9	130.5	130.5	143.9	140.8	146.4

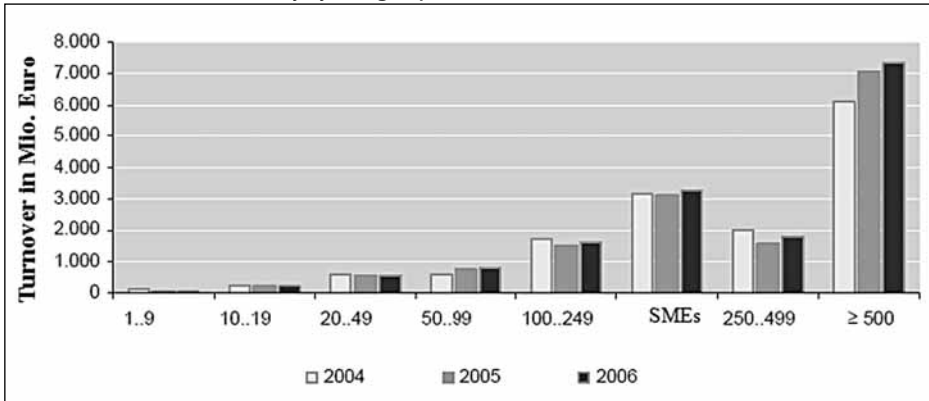
^{*} joint patent applications are divided by the number of partners, so that decimal numbers may occur.

Source: Patentatlas Deutschland 2006, p. 136.

In 2005, 28.7 patent applications per 100,000 inhabitants and 60.4 patent applications per 100,000 employees with 10 patent applications per 100 R&D employees had been recorded in the economic sector. The ratio of patent application from the economic sector grew steadily from 58.2 % in 2000 to 70.0 % in 2005 (Patentatlas Deutschland, 2006, p. 133-138).

In recent years the Saxon manufacturing sector has shown a positive development. In 2006 enterprises with continues R&D activities had a share of 22.6 % in **manufacturing turnover**, while their share in all enterprises was just 11 %. The survey of Günther et al. revealed that about 75 % of the interviewed enterprises in the SAB innovation programmes declared a growing turnover. Indeed, the development of turnover between 2004 and 2006 differed largely within the size groups and SMEs had only small gains (cf. Graph 1.8).

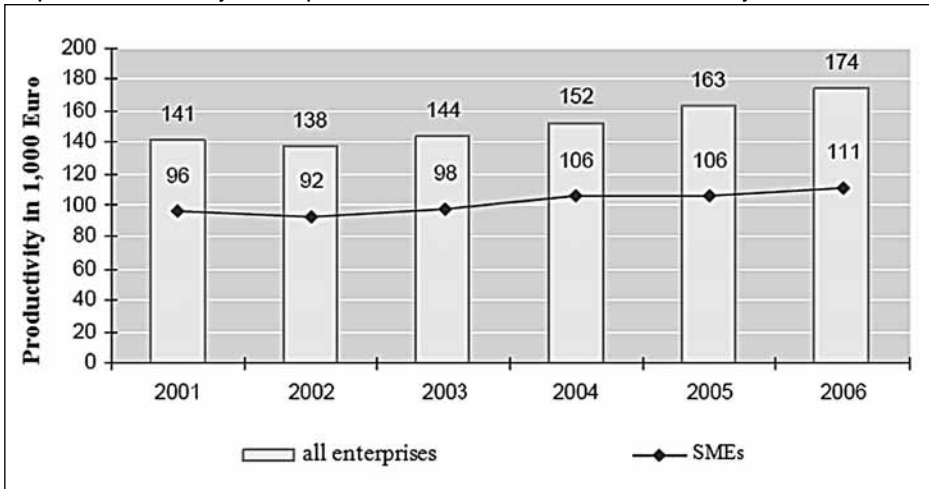
Graph 1.8 Turnover of enterprises with continuous R&D activities in the Saxon economy by size groups in 2004-2006



Source: Konzack et al., 2007.

The **productivity** of Saxon enterprises with continuous R&D activities, as measured by turnover per employee, has grown since 2002. However, in SMEs this growth was more modest than in larger firms (cf. Graph 1.9 and Graph 1.10).

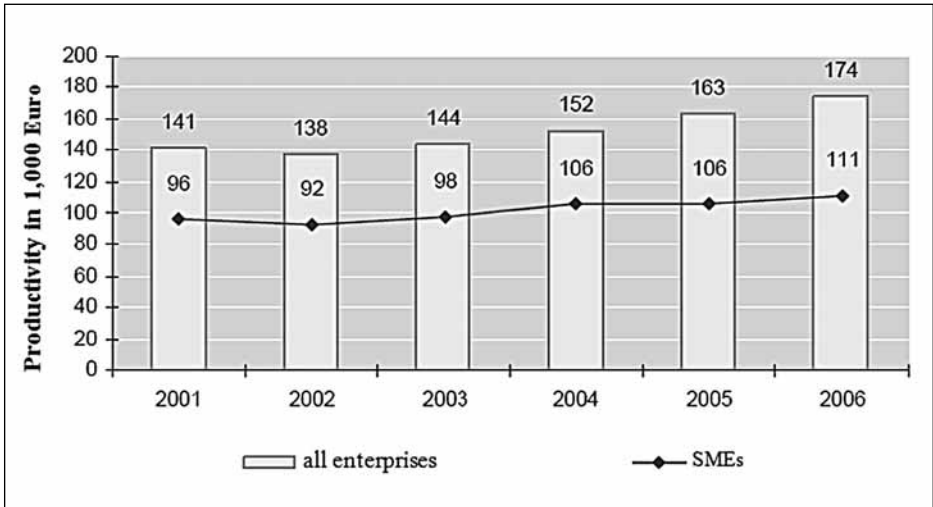
Graph 1.9 Productivity in enterprises with continuous R&D activities in Saxony 2001-2006



Source: Konzack et al., 2007, p. 48.

Günther et al. indicate that less than 2 % of the enterprises interviewed declare substantial losses of market share while 51 % were able to expand. Regarding the share of export in the total turnover they showed an average growth from 16 % in 2000 to 22 % in 2006 (Günther et al., 2008, p. 86-90).

Graph 1.10 Productivity in enterprises with continuous R&D activities in Saxony 2006 by size groups



Source: Konzack et al., 2007, p. 49.

Concerning the evaluation of specific programmes, it has to be mentioned that Günther et al. hardly discussed the impacts of innovation promotion on effectiveness. Indeed, they admitted that **deadweight effects** might exist. 78 % of the interviewed firms stated that they would downgrade R&D activities if their support was reduced. That means that about 20 % of enterprises would have realised their research project even without SAB support. Furthermore, 72 % of the enterprises declared that as a consequence of SAB R&D support they changed or expanded the focus of their research (Günther et al., 2008, p. 98-100).

Due to its possible positive external effects **cooperation** is seen as another important feature in R&D promotion. Empirical evidence of improved performance by enterprises which were supported by the network programme could not be found. An interesting result of the survey was that the firms interviewed hardly feared an outflow of know-how due to cooperation, rather they showed a great deal of trust in their partners. This could be due to the fact that cooperation support in Saxony was given exclusively for cooperation between enterprises and research institutions, the latter doing basic research while the firms were responsible for product development (Günther et al., 2008, p. 100-103).

The success of an economic support system not only depends on economic effects but also on the **acceptance** of the system by its recipients. The transaction costs of the support system at the plant level are especially important. The satisfaction with the Saxon support system relating transparency of the programme, of allocation, consultation, the amount of support etc. was rather high. The expert interviews show that the pragmatic approach of the Saxon R&D support system, its close relationship with the SAB, and the rather transparent system of rules are regarded positively. The fact that SAB precedes an internal technical evaluation of R&D projects so that the applicant

does not have to fear uncontrolled proliferation of the knowledge advantage was highly appreciated. This fact was regarded as a substantial advantage of the Saxon support system compared to the federal and EU programmes.

The administrative efficiency of SAB was also satisfactory. The average time necessary for enterprises to file the first application for an innovation assistant was 9 person days; 20 person days were needed for plant-related individual R&D project support applications. The support scheme application for R&D cooperation needed an investment of 22 person days at the plant level and 33 person days at the research unit level. The time taken to submit subsequent applications decreased significantly in all parts of the support system. The processing time for applications for financial support by the SAB was between 11 and 18 weeks.

Altogether, Günther et al. attribute a positive role to recent Saxon R&D promotion. The three lines of support, i.e. the funding of individual R&D projects, the support scheme for R&D cooperation and the funding of innovation assistants, have been successful and should be continued in the present manner. The open approach towards technology within the context of the Free State of Saxony's R&D project support should be preferred over a focus on certain technologies. The process of competition has enforced "natural selection" among Saxon plants and research units; this means different plants focus on different fields of technology in which they show comparative advantages. Limiting funding to certain fields of technology could lead to the misallocation of resources and thus to a loss in international competitiveness.

Concerning administration, they demand that the time taken to reach decisions on applications should be reduced. In addition, the practice of plants being allowed to start projects at their own risk before gaining application approval should be continued. This allows plants to act in a timely and market-oriented way. Another result was that a large proportion of plants would reduce or stop R&D activities if the level of support was lowered. Thus, the support programmes should not be reduced in qualitative terms. Also a change from non-repayable grants cannot be advised under the given circumstances and support rules. Repayable grants would mean that plants would have to factor in paying back financial supplements right from the start. This would reduce the financial freedom of plants and would lead to them undertaking less risky projects or reducing their R&D activities. Increased availability of support for technologically sophisticated and risky innovations should be examined. Finally, it should be ensured that SME have priority (Günther et al., 2008, p. XXII).

1.5 Summary

This paper discussed the impact of EU Cohesion Policy on Innovation in SMEs in East Germany with a special focus on Saxony. Due to German and European innovation policy being increasingly interlocked and German and European resources often flowing into common programmes it was necessary to consider the innovation policy for the benefit of SMEs as a whole. In view of the weakness of the East German SME sector, the federal government as well as the East German states developed a number of special pro-

grammes for this area. Since the end of the 1990s these programmes have been continuously evaluated and subsequently adapted. In accordance with the Lisbon Strategy the focus of innovation support and the subject of innovation programmes switched from innovative production methods towards the development of innovative products and their commercialisation. Additionally, new programmes are focused more closely on the deficits, for instance, by stepping up the technology transfer from research institutes to industry or to focus the promotion of R&D personnel to network assistants. Altogether, the evaluation of the recent East German and Saxon innovation programmes attributed a positive role to R&D promotion to the benefit of SMEs. East German patents were even higher concentrated in high-tech branches (except for computer technology) than West German which should be a competitive advantage in the middle- and long-term perspective. Yet, compared to the West German innovation performance, the gap has not been closed. Even in 2008 only few East German SMEs were able to finance innovation by private funding. So there are strong arguments for continuing special innovation support for East German SMEs. However some risks have to be taken into consideration, including dependence effects, deadweight effects, and free rider effects. Proposed actions to reduce these effects, i.e. to raise the enterprise's share in supported innovation projects, were regarded as unrewarding because of the weak financial situation of East German SMEs.

The evaluation of the Saxon innovation programmes generated the following recommendations:

- It should be secured that SMEs really have priority within the innovation programmes and in their approval.
- An open approach towards technology within the context of the R&D project support should be preferred over a focus on certain technologies.
- Innovation support should build on the strengths of the given economic structure but focus on high technology where existing.
- The applicants should be allowed to start projects at their own risk before gaining application approval. This allows plants to act in a timely and market-oriented way.
- The time taken to reach decisions on applications should be as short as possible.
- The weak status of SMEs in Eastern Germany does not allow R&D support to be radically reduced or stopped. Also a change from non-repayable grants cannot be advised under the given circumstances and support rules. This would reduce the financial freedom of plants and would lead to them undertaking less risky projects or reducing their R&D activities.
- The increased availability of support for technologically sophisticated and risky innovations should be examined (Günther et al., 2008, p. XXII- XXIII).

A more general recommendation was that innovation policy cannot be assessed independently of other areas of policy. It is important to harmonise all the support systems. In particular, innovation policies and education policy should have stronger interlocking. The expected shortage of qualified personnel in many East German regions will be a challenge that will be difficult to meet. An interesting instrument to face this challenge was implemented in Thuringia, where SMEs can apply for studentships; the enterprise then transfers them to students or Ph.D. students who do research in their thesis exclusively

for the applying SME. It was further recommended to interlock regional and innovation policy, however, as these policies follow different aims – equalisation the first, economic growth the second – it is important to find a balance without intermingling.

Due to its distinct additionality and the strong innovation support of local, state (Länder) and federal government in SMEs, the exclusive impact of Structural Funds efforts in Saxony is hard to assess. But to sum the conclusions of chapter 1.4 up there is no doubt of the positive impact of the EU Structural Funds programmes on SME's innovation during the last two decades. Saxon SMEs, despite their weakness and the unfavourable size structure, achieved constant innovation progress over recent years, a result which would not have been possible without the Structural Funds support. As this impact is hard to quantify we concentrate on some major outcomes in the field of innovation promotion in SMEs:

- Trend setter: Since the federal and state driven programmes are more focussed on material investment, labour market and financial transfer the EU Structural Funds programmes were the first to address innovation promotion exclusively.
- Constancy: Due to the fiscal weakness of the Eastern Länder and the volatility of federal efforts especially by changing programme lines and priorities, the EU Structural Funds support created a reliable environment for SMEs investment in innovation and technology.
- Focus on the human factor: Based on the ERDF and ESF instruments, the EU funded programmes were the first to close the gap between enterprises and academic institutions, to fund start-ups and applied research and thus to find an integrated way for progress in both the economy and (higher) education. Besides highlighting this interface with the support of the EU Structural Funds it became possible to stabilise the R&D-employment in the Eastern Länder and to create the first networks among SMEs and research institutions. Only in recent years was the latter approach applied by federal and state funded programmes.

2

SMALL AND MEDIUM ENTERPRISES AND THEIR SUPPORT FROM THE OPERATIONAL PROGRAMME “INDUSTRY AND SERVICES”

In this case we introduce selected aspects and problems of the support for the development of small and medium enterprises (SMEs) from EU structural funds. We start by briefly describing the history of SMEs in Slovakia. The second part evaluates results from the sectoral Operational Programme “Industry and Services” (OP IS) as the main instrument supporting SMEs development from the structural funds during the shortened programme period 2004-2006. The results and outcomes from this programme are still not very positive, thus we also look at selected current approaches to improve the situation. Respecting the availability of data, we always provide a country-wide perspective and wherever possible also specific data for one selected region – Banská Bystrica – Žilina (Stredné Slovensko – NUTS II level). This region comprises of two self-governing regions Banská Bystrica and Žilina and covers the central part of the Slovak Republic. The Žilina region has 694 763 inhabitants and 6 808 sqm, the Banská Bystrica region 657 119 inhabitants and 9 455 sqm. Because their size is significantly below EU requirements for NUTS II, they must co-operate within the EU programming space.

2.1 Economic Transition and its Impact on the Development of the Slovak SME Sector

Small and medium enterprises normally represent the core level of any national economy. In Slovakia (at that time Czechoslovakia) the first “market” SMEs were established soon after the change in 1989 via two mechanisms. One group of SMEs was established as the result of privatisation and restitution, mainly on the basis of former national or local enterprises. The second group are newcomers, firms entering the market with new ideas and businesses.

The development of the SME sector in Slovakia was relatively fast and its first phases up to the end of the last century are characterised by the following table 2.1.

Table 2.1 SME growth in Slovakia up to 2000

Year	Small enterprises	Medium enterprises (up to 500 employees)	Medium enterprises (up to 250 employees)
1992	16973	2344	
1993	23828	2847	
1994	30977	4337	
1995	37868	4977	
1996	43753		3284
1997	49740		3257

Year	Small enterprises	Medium enterprises (up to 500 employees)	Medium enterprises (up to 250 employees)
1998	56202		3343
1999	54349		3294
2000	57247		3063

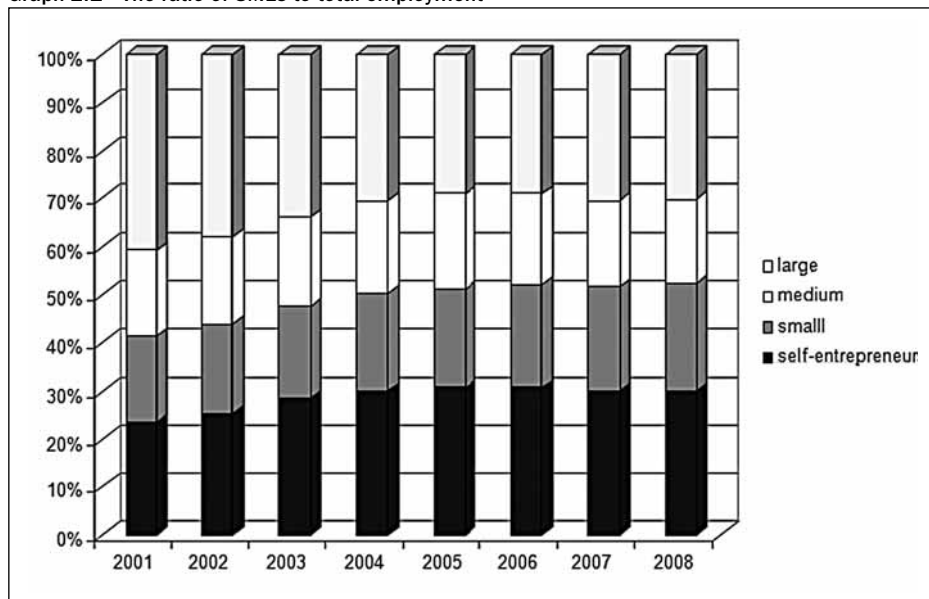
Source: yearly reports on SME situation, www.nadsme.sk.

Very soon during the transformation, SMEs became a very important tool for developing all regions. Because of this fact they are also supported by several programmes, including EU funds.

Such support fixed the natural development trends of the SME sector. In the following figures we present the main data on the importance of SMEs after 2000, globally and in the examples of our selected regions.

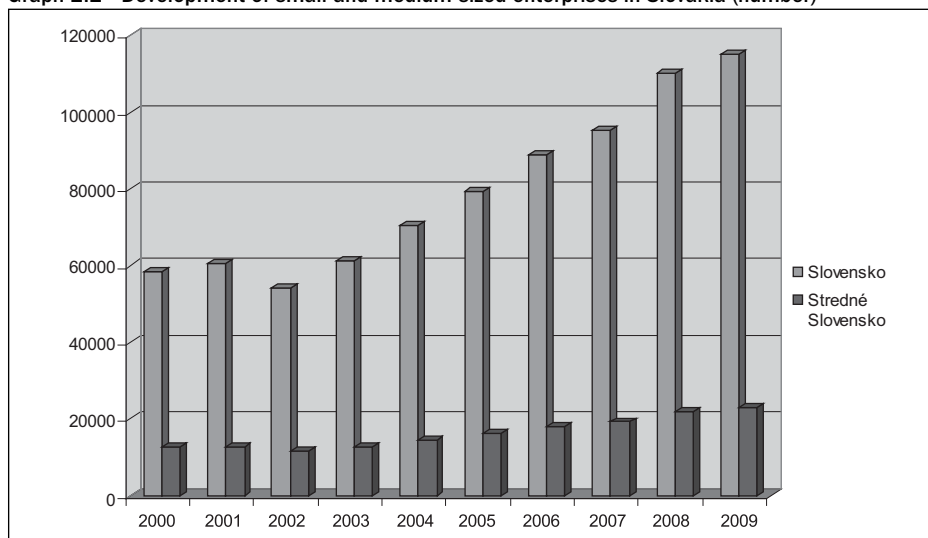
Graph 2.1 indicates that the proportion of SMEs employees to total employment grew with some stabilisation after 2007. Its current level is close to 70 %. Certainly, from the point of view of SMEs' rate on output indicators, the situation is slightly different – for example they created about 40 % of total revenues or export.

Graph 2.1 The ratio of SMEs to total employment

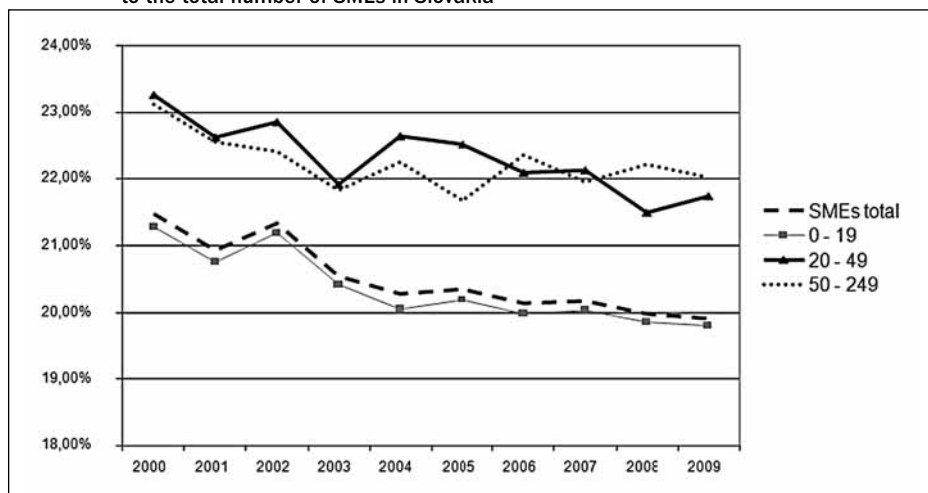


Source: National Agency for Development of Small and Medium Enterprises: Status of Small and Medium Enterprises in Slovakia 2008.

From the point of view of our region, Stredne Slovensko, the data (Graph 2.2 and Graph 2.3) characterizing the development of the sector after 2000 signalize a growing trend, but also the fact that the region is still underdeveloped, especially in the category SME below 20 employees.

Graph 2.2 Development of small and medium-sized enterprises in Slovakia (number)

Source: <http://px-web.statistics.sk/PXWebSlovak/>.

Graph 2.3 The share of SMEs in Stredne Slovensko region compared to the total number of SMEs in Slovakia

Source: <http://px-web.statistics.sk/PXWebSlovak/>

The data provided by Graph 2.2 and Graph 2.3 indicates that the effective support for the development of the SME sector in the Stredne Slovensko region may be very important. In the next part we evaluate to what extent the EU funds availability provided such support during the last programming period.

2.2 The Operational Programme Industry and Services and its Impact on SMEs Development

In the previous shortened program period (after joining the EU on 1. 1. 2004) the main source for support of SME sector investments development was the Operational Programme Industry and Services. The Table 2.2 characterizes its scale and main contents. In the later text we evaluate the main outputs/results/impact from the OP at the national global level and, wherever possible, also for the SME sector and the selected region.

Table 2.2 Sectoral OP Industry and Services (2004-2006)

Measure	Calls	Projects submitted	Projects approved plus reserve	Actual allocation total (EUR)	Requested allocation (EUR)	Approved allocation (EUR)	Contracted allocations (EUR)
1.1.	Scheme "State Support"	416	50 (+9)	38,066,655	259,467,737	38,052,263	32,018,170
	Scheme "Support de minimis"	580	90 (+269)				
1.2.	Public sector – incubators and technology centres	17	8	57,322,946	176,962,105	60,034,210	48,933,060
	Individual national projects	2	1				
	Public sector – industrial parks	52	16 (+5)				
1.3.	Scheme "Support de minimis"	63	52	5,524,175	10,286,053	6,546,842	4,164,754
	Scheme "State Support"	28	21				
1.4.	Scheme "Support de minimis"	23	17	21,046,876	41,009,736	23,346,578	19,591,511
	Scheme "State Support"	41	34				
1.5.	Scheme "Support de minimis"	9	6	2,456,233	6,527,105	2,506,052	1,995,049
	Scheme "State Support"	109	48 (+15)				
2.1.	Public sector projects	132	23	40,078,391	184,032,894	38,468,421	38,164,976
2.2.	Scheme "State Support"	336	40 (+19)	35,256,932	233,508,421	34,289,473	34,155,972
2.3.	National project	1	1	199,752,208	911,791,051	203,243,839	179,023,492

Source: OP evaluation report

2.2.1 The Impact of the OP on Employment Growth (the Core Priority)

Table 2.3 provides data characterising the impact of the OP on the growth in employment in Slovakia and, partly, also in the region in the area of industry and services.

Table 2.3 Impact of the OP on the growth in employment

	Jobs at 31. 12. 2003	Jobs at 31. 12. 2008	Change	Added by the OP	OP share of the overall change (%)
Slovakia total	766 168	858 614	92 446	3 036	3.28 %
West	335 297	396 197			
BB - ZA	211 481	228 574			
East	219 390	233 843			
In it:					
Industry total	484 754	530 613	45 859	2 495	5.44 %
Industry men	307 519	339 461	31 942	2 110	6.61 %
Industry women	177 235	191 152	13 917	385	2.77 %

Source: own calculation on the base of data from OP evaluations.

According to the existing statistical data the OP created a total of 3 036 new working places in Slovakia, with better success in industry compared to services. This figure disaggregated to regions was not available; in any case the given data does not provide a very successful picture. In 2008 the OP only created 385 new jobs for women in industry, thus contributing to an overall employment increase of 2.77 %. One core issue is the fact that most new jobs were occupied by men, but this fact might be partly caused by the character of the newly created jobs being more attractive to men.

The impact of the OP on the labour market in general for Slovakia, but also for the given region, cannot be assessed as sufficient. Most new jobs in the SME area were created by natural economic development, especially via direct foreign investments in the western part of the country. Moreover, planned OP targets were not achieved (Table 2.4 for Slovakia, disaggregated figures not available).

Table 2.4 Planned targets in employment area for the OP [Slovakia total]

Indicator	Planned	Reality: 31. 12. 2008	Reality: 31. 12. 2009
New working places	7500	3036	5236

Source: own calculation on the basis of data from OP evaluations.

2.2.2 Other Indicators of OP Outputs/Impacts/Results

Another important priority indicator describing outcomes delivered by the OP in the SME area was **value added**. Table 2.5 provides data on it.

Table 2.5 Value added in SMEs supported by the OP [standing prices]

	2001	2008	Value added growth Slovakia	Value added growth for subsidised enterprises (2001=100 %)
West	2 644 516.03	3 975 625.84	150.33 %	
BB - ZA	1 370 111.00	2 090 425.48	152.57 %	
East	1 320 276.11	2 028 962.36	153.68 %	
Slovakia total	5 334 903.14	8 095 013.68	151.74 %	175.15 %

Source: selected data from OP evaluations.

As can be seen from Table 2.5, the OP seems to have supported improved economic efficiency in production in the subsidised enterprises. From this point of view we may evaluate its impacts on SME developments as being positive.

It might be expected that good results concerning value added will be followed by positive figures for the area of **labour productivity**. However, this did not happen. Calculated data about labour productivity in industry (according to the annual OP IS monitoring report) for the period 2001 to 2008 showed growth of only 35.8 %. This is far too low compared to general figures (for example the labour productivity in the non-supported Bratislava region increased by 96.9 % during the same period).

Table 2.6 gives the most important output indicators characterising results of the OP in the SME area – data cannot be disaggregated for the region under study. Implementation problems are clearly visible; only one indicator – the number firms supported, has been achieved during the planned period. This means, resources have been distributed, but their effectiveness is in fact low. In the following text we discuss the reasons for such a situation.

Table 2.6 Output indicators OP

Indicator	Planned (2006)	Reality 31. 12. 2008	Reality 31. 12. 2009
Number of supported SMEs	700	366	822
Number of industrial innovations	30	15	15
Number of new exporters	70	41	41
Number of monuments renovated	20	13	13
Number of tourism enterprises supported	50	66	66

Source: own calculation on the basis of OP evaluations.

2.2.3 Reasons for the Limited Success of the OP Industry and Services in Developing SME

As indicated in part 2.3, a relatively high amount of resources from EU funds have been distributed in the form of direct support to help to develop the SME sector in Slovakia – in all 822 small and medium firms received grants. It is also clear that the allocated money does not deliver the planned and necessary outcomes.

What are the most important reasons for this negative situation? We could mention several of them, including such sensitive issues as bureaucratic failures (and corruption?) during the selection of projects, limited absorption capacity (for both see for example Sumpikova and Potluka, 2003), or “deadweight expenditures”, described in our second case study. In the following text we provide more facts about another important issue – administrative barriers that seem to limit the chance of many SMEs being successful in the application process. Later on, failures of indirect support measures are documented.

2.2.4 Administrative Barriers

It is well known that there are comprehensive administrative requirements connected to the preparation, but also realisation of projects. Most SME simply do not have the

capacity to cope with such complexity and must hire a specialised company to help. This leads to extra transaction costs, decreasing the real efficiency of support (according to some of our interviews with managers of firms up to 30 % of the allocated grant is spent on transaction costs – certainly these expenditures are not eligible and must be covered by internal sources).

Despite the professional help too many proposed projects are refused because of formal mistakes. Table 2.7 provides data describing the relations between the number of projects submitted and projects rejected for old and new Operational Programmes accessible to SMEs.

Table 2.7 Success rate – projects submitted (OP Industry and Services and OP Competitiveness and Economic Growth)

OP Industry and Services – de minimis calls						
	Original decisions	Decisions with revisions	Banska Bystrica (BB)	Zilina (ZA)	% BB	% ZA
Number of applications	580	580	101	78	100.00 %	100.00 %
Rejected applications	220	220	36	27	35.64 %	34.62 %
- formal reasons	150	150	23	18	22.77 %	23.08 %
- selection process	70	70	13	9	12.87 %	11.54 %
Approved projects	87	90	16	10	15.84 %	12.82 %
Projects kept in reserve	272	269	49	41		
OP Competitiveness and Economic Growth 2008						
	Slovakia	BB	ZA	% BB	% ZA	
Number of applications	205	34	38	100.00 %	100.00 %	
Rejected applications	118	18	28	52.94 %	73.68 %	
- formal reasons	104	16	25	47.06 %	65.79 %	
- selection process	14	2	3	5.88 %	7.89 %	
Approved projects	87	16	10	47.06 %	26.32 %	
Projects kept in reserve	0	0	0			
OP Competitiveness and Economic Growth 2009						
	Slovakia	BB	ZA	% BB	% ZA	
Number of applications	164	31	26	100.00 %	100.00 %	
Rejected applications	90	16	16	51.61 %	61.54 %	
- formal reasons	55	11	8	35.48 %	30.77 %	
- selection process	35	5	8	16.13 %	30.77 %	
Approved projects	74	15	10	48.39 %	38.46 %	
Projects kept in reserve	0	0	0			

Source: own calculations on the basis of evaluation reports for the programmes.

The data clearly show that in some cases more than 50 % of applications do not meet the criteria at the first stage – formal control of projects. This means many effective projects are disqualified at the start, increasing OP transaction costs and decreasing the

chances of positive outcomes and results. The real warning figure is the fact that within the framework of the evaluated Operational Programme Industry and Services only 15 % of submitted projects received the support. The amount of “sunken” costs generated by such a high failure rate might outweigh the positive impacts from the OP.

In such conditions the chance for success in the application process is very much connected to previous experiences (and contacts?), which most new SMEs, the core focus of the OP, do not have. According to programme evaluation data about 50 % of allocations are given to SME older than 9 years (this fact may explain why targets for newly created jobs were not reached).

2.2.5 Indirect Support for New SME Businesses – (Unused?) Potentially Effective Alternative to Direct Subsidies

The data and information provided above indicates that direct forms of supporting SMEs from Operational Programmes may not be effective enough (moreover, the fair competition principle might be obstructed by this manner of support, giving competitive advantages to a few select firms).

Taking this into account the OP also includes measures of indirect support to the SME sector that seem to play an important role in the development of this sector. The two core initiatives are business incubators and industrial parks. However, this line also fails to function in an effective manner. We document this problem in the examples from the Stredne Slovensko region.

The OP Industry and Services in the Stredne Slovensko region chiefly focused on direct support. Most projects for indirect support prepared by municipalities or their associations were stopped in the formal control phase of the selection process. The rate of success in this area was very low and, moreover, the results of the approved projects are dissatisfactory. In the following text we highlight some facts from the Banska Bystrica self-governing region.

Industrial Parks

In the Banska Bystrica region only four project to build industrial parks were supported, namely Detva, Lucenec South, Viglas and Hnusta. None of these parks has been fully utilised yet. We provide selected data on all of them.

The industrial Detva project was approved in 2005 and received a grant of more than 6.5 mil. EUR. The recipient was the city Detva, which that promised new jobs for 528 people and technological investments in the park. So far the planned targets have not been achieved, running the risk that there might be a request for the allocated grant to be returned.

The first fact is that this industrial park, after opening in 2007, did not help the SME sector, but most capacities were given to the company PPS Group and its subsidiaries – a large machine industry firm. The starting phase was OK – within the first year of the existence of this industrial park 6.7 mil EUR of new investments were realised and 185 employees received new jobs. However, the financial and economic crisis halted these positive trends (clearly underlining the risks of “giving” the park to one large company). In 2008 PPS Group was laying off workers and more than 1000 people lost their jobs. It

is an open question as to whether the economic recovery will help revert this trend back to sufficiently positive figures to prove the measure's effectiveness.

The industrial park Lucenec South project was approved in 2006 and granted just over 3 mil. EUR. The goal was to attract three investors into the park. In 2010 there are still only two investors building their capacities in the park. The first SME in the park is Milenium Trading, focusing on processing plastic waste. The firm invested 20 mil. EUR (including a 13 mil. EUR grant from OP Environment) and should start preliminary operations in 2010. It plans to employ 50 persons. The second investor (the Italian firm Bovinex Europe) signed a contract with the city in October 2009 and it plans to focus on the producing solar energy devices.

The industrial park Viglas was granted almost 1.5 mil. EUR and opened in November 2008. At the time of opening two contracts were signed with future potential investors – the medium enterprise Burgmaier (200 employees planned) and the medium enterprise IPEC-Real (60 employees planned). However, no investment activities started; moreover Burgmaier decided to withdraw from the contract and will not invest in Viglas. The municipality tried to attract other investors with some success. One firm Protel may start to invest into producing solar energy devices in 2010. The current situation is that from the planned 500 – 800 jobs the reality is no jobs by mid 2010.

In 2007 the industrial park Hnusta received a grant of 2.3 mil. EUR to revitalise the area of the bankrupted firm T-GUM Hnusta. Compared to the previous cases the park was able to attract three investors. The Korean electro technical industry firm YURA ELTEC Corporation Slovakia, limited .is closely connected with KIA Motors Slovakia Žilina and HYUNDAI Motor Czech Nosovice. In 2009 the firm received a grant of 3.1 mil. EUR to create 701 new jobs. Currently the firm employs about 3 700 persons in its branches in Lednicke Rovne, Hlohovec, Hnusta and Rimavska Sobota, but does not plan any future growth. The Austrian based firm RW-Tech-Gum focuses on machine production and T-GUM Hnusta focuses on rubber industry products.

Business incubators

In the Banska Bystrica region two incubators received support from the OP Industry and Services. The first grant was given to the city Rimavska Sobota (project Business incubator second generation) and the second one to the self-governing region (the project Support for the Research and Development Potential of SME by Establishing a Research and Development Centre for the Machine Production and Wood Industry in the Banska Bystrica Region).

The project in Rimavska Sobota is a clear example of good intentions but implementation failures. The grant was 85 650 EUR and the goal was to support new small businesses, for example by providing them with IT technologies, e-business training, etc. In September 2009 the effectiveness of the incubator was reviewed by the National Agency for Development of Small and Medium Enterprises and it proposed to cancel the contract, because the planned targets had not been achieved. The interest of potential new entrepreneurs was very limited, far fewer than the planned number of new jobs were created (only 46 instead of the planned 350). The city is obliged to return the grant.

To summarise, we can but stress than not only direct but also indirect support for the development of the SME sector from the Operation Programme Industry and Services failed to deliver the expected results and outcomes.

2.3 Conclusions

As indicated in Table 2.2, relatively important sums of money have been spent on supporting the development of the SME sector from the Operational Programme Industry and Services. Our brief analysis indicates that the efficiency and effectiveness of this spending is doubtful. This may be natural, because this was the first programming period in Slovakia following accession, with limited previous experience. However, similar problems are also visible during the current programming period (see for example Table 2.7 and also our second case study in this book). We can but hope that the evaluations by the OPs supervisory boards and independent evaluations, like ours, will provide effective inputs for future improvements.

3

“SUBSTITUTION EFFECTS” OF EU OPERATIONAL PROGRAMMES: SELECTED EVIDENCE FROM BANSKA BYSTRICA REGION

This case study analyses the scale and selected purposes for the existence of the substitution effect/deadweight spending (term explained below) created by grants provided via EU programmes. The substitution effect is typically connected with most types of public expenditures and its size depends on the quality of a programme’s design. Its existence is based on the fact that almost all public grants influence the behaviour of a recipient and consequently inefficiencies are created.

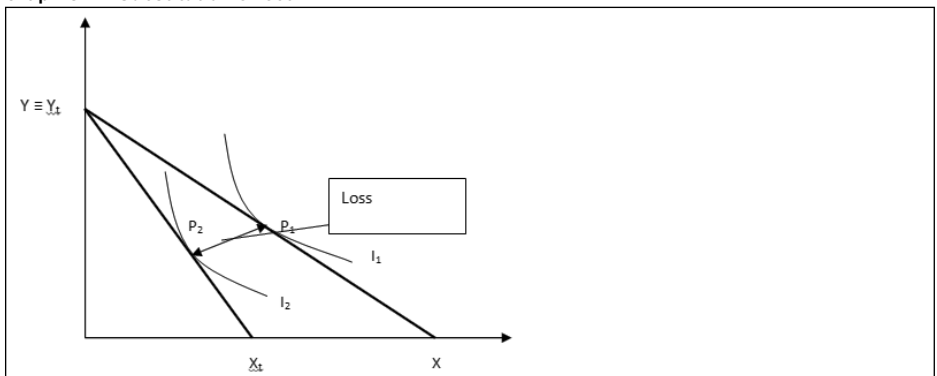
The case study starts with a brief theoretical introduction. Afterwards it tries to estimate the scale of the substitution effect and its purpose in the example of the specific conditions of the Banska Bystrica region.

3.1 The “Substitution Effect – Deadweight Spending” of Public Expenditure Programmes

The substitution effect is one of the important negative aspects connected with both taxation and public expenditure programmes. If connected with taxation (see for example Stiglitz, 1988; in our conditions Kubatova and Vitek, 1997; Medved et al., 2009) the substitution effect is called “deadweight loss”. The issue of the substitution effect of public expenditures – “deadweight spending” has had less investigation compared to taxation, but it is also well explained by economic theory (Stiglitz, 1988 and many others, in our conditions for example Hamernikova and Kubatova, 2000).

The principle of the substitution effect is very simple – taxation or public expenditures influence the relative prices and consumers substitute goods or services with others. The principle of the substitution effect is shown in Graph 3.1.

Graph 3.1 Substitution effect



Despite the fact that it is very difficult to measure the substitution effect of public expenditures and especially that of public development grants (see for example Martini, 2009⁴), several authors (Lenihan, 2004; Tokila and Haapanen, 2009) try to measure the deadweight spending of expenditure programmes focusing on regional development policies. Lenihan (2004, p. 229-252) estimates that deadweight spending for Irish industrial policy programmes ranges from 40 – 80 % of the total sum of grants provided. Leninah and Hart (2004, p. 817-839) also estimate Irish conditions at 42.6 – 55.8 %. The Tokila and Haapanen (2009) estimate in the case of Finnish business policies is 31.9 %. In the Czech conditions we know of only one such study, realised by Sumpikova and her team (GACR project) – see for example Sumpikova (2007). All the collected data provide important warnings for operational programmes policies.

The alternative possibility to estimate the substitution effect is to measure the effects of policies (we will not focus on this issue in our case). According to Mairate (2006) EU regional policies caused a significant increase in investment projects realised in Member States – for example in Austria the growth was 36 %, in Sweden 14 %, in Ireland 66 % and in Greece 24 %.

3.1.1 Our Methodology to Estimate Deadweight Spending in the Banska Bystrica Region

In our case the question connected with the existence of the substitution effect caused by expenditures from regional operational programmes is:

“Would the project be feasible and sustainable without support from operational programme funds?”

For cases where the response is “no”, this question should be supported by the next set of questions, especially:

1. What is the level of inefficiency caused by the substitution effect?
2. If the inefficiency is higher, is it possible to use allocated sums in a more effective and efficient way? Can allocated resources be better used by the private sector, if not withdrawn from it?

Because such complex research is not our target in this case, we focus only on the first core questions, telling us, if deadweight spending is a reality within operational programme funding in the Banska Bystrica region.

To obtain some data we used the Finnish approach (Tokila and Haapanen, 2009). This approach investigates what would happen, if the proposed project is not supported from the programme. The following options are accepted:

1. The project will not be realised.
2. The project will be implemented at a reduced size.
3. The project will be fully implemented, but with lower quality.
4. The project will be fully implemented, but with a delay.
5. The project will be fully implemented.

⁴ Martini for example states that “The common problem with such policies is that some eligible units might have adopted the action anyway, even without the subsidy”.

The first response represents full deadweight spending, responses 2-4 partial deadweight spending and only in case 5 is the project fully effective. The total deadweight spending of the programme is calculated using the following formula:

$$d_i = s_i \delta_{ij} \quad j=1,2,3,4,5$$

Our estimate for the deadweight spending level for all the given alternatives is as follows:

- $\delta_1 = 0$ (response 5)
- $\delta_2 = 0.25$ (response 2)
- $\delta_3 = 0.5$ (response 3)
- $\delta_4 = 0.75$ (response 4)
- $\delta_5 = 1$ (response 1)

3.2 Selected Reasons for the Existence of Deadweight Spending – Substitution Effects in Conditions of the Banska Bystrica Region

In this part we try to provide certain important examples when the evaluation system of the operational programme is one of reasons for possible deadweight spending. These examples, for instance, indicate that the current evaluation rules frequently create incentives to start activities, businesses that would never be effective and sustainable in standard market conditions.

3.2.1 The Use of the Altman Index in the Selection Process

According to the approved rules for evaluating the Operational Programme Competition and Economic Growth, axis 1, it is compulsory to assess the financial situation of the applicant on the basis of a complex financial analysis indicator: the Altman index. To provide some background for these not fully familiar with enterprise finance, the construction of this index is explained in Box 1.

Box 3.1 Altman index

The Altman index includes the following sub-indicators:

x1 – working capital/total actives

Enterprises with a higher proportion of permanent assets in total assets have lower liquidity rates and thus the probability of default increases.

x2 – profit after taxation/total assets

The enterprise may finance its needs through its own or external resources. Short term and long term credits, if too high, create the risk of defaults.

x3 – profit before taxation + interest/total assets

This indicator deals with the profitability of the total invested capital. High levels mean low probability of default.

x4 – accounting value of own capital/accounting value of external capital

A low value of this indicator suggests that the probability of default is high.

$x5 - \text{revenues}/\text{total assets}???$

This indicator measures the speed of asset turnover. Low speed indicates the risk of default.

All the above mentioned indicators were aggregated by Altman into general equations for different types of enterprises, as follows:

1. Altman index for firms quoted on stock exchange = $1.2x1+1.4x2+3.3x3+0.6x4+1.0x5$

If: $Z > 2.99 \Rightarrow$ the financial situation is good

If: $1.81 < Z < 2.99 \Rightarrow$ the firm is in the grey zone, the risk of default exists

If: $Z < 1.81 \Rightarrow$ the firm has major financial problems, the default is highly probable.

2. Altman index for other standard firms = $0.717x1+0.847x2+3.107x3+0.420x4+0.998x5$

If: $Z > 2.9 \Rightarrow$ the financial situation is good

If: $1.2 < Z < 2.9 \Rightarrow$ the firm is in the grey zone, the risk of default exists

If: $Z < 1.2 \Rightarrow$ the firm has major financial problems, the default is highly probable.

3. Altman index pre non-industrial and new firms = $6.56x1+3.26x2+6.72x3+1.05x4$ (3)

If: $Z > 2.6 \Rightarrow$ the financial situation is good

If: $1.1 < Z < 2.6 \Rightarrow$ the firm is in grey zone, the risk of default exists

If: $Z < 1.1 \Rightarrow$ the firm has major financial problems, the default is highly probable.

The core problem connected with the compulsory use of the Altman index, when evaluating projects within the Operational Programme, is the fact that this index cannot be used as a sound indicator of the financial health of SMEs submitting proposals. The reason is very simple.

The Altman index was constructed for short term predictions in a North American environment and cannot be applied without alterations respecting the specifics of local conditions. For example for Slovak conditions the model does not include the problem of payment insufficiency of Slovak enterprises. The model, moreover, cannot be adapted to Slovak conditions, because the sample of enterprises after the final default is too small.

The use of an inappropriate basis for evaluating projects may prevent the selection of several effective projects and increases the likelihood of deadweight spending. Fortunately, the Altman index is not used for other axes of the OP.

3.2.2 The “Imperfect” Evaluation Rules

An important part of the evaluation of a project submitted to the Operational Programme analysis is an analysis of the profitability of the proposed project. We focus on two issues connected with this evaluation:

1. The methodology to decide if the project is financially sound – efficient.
2. The problem of the discount factor used for the calculations.

To document the problem, in the final part of our text (Boxes 2 – 4) we use the data obtained by direct research (students supervised by the faculty) in firms.

One core problem of the evaluation mechanism is the fact that all financial data is calculated including the planned amount of the grant and it is not compared to results without the grant. To be accepted, the project must show a minimum given level of profitability for the given period. The prescribed steps of the evaluation are as follows:

1. Calculating the discounted (5 % discount rate) profit of the project.

2. Calculating the discounted investment costs.
3. If the result is profit, the project cannot be supported (!).
4. If discounted profit cannot cover discounted investment costs, up to 95 % of the difference can be covered by an OP grant.

The problem with this approach is the fact that the rules to calculate future economic results allow non-realistic inputs to be inserted so that it fits into the scheme and can obtain maximum support. Certainly this allows the space for deadweight spending to open, thanks to “creativity to manipulate estimates”, especially on the side of future profit. Calculations/estimates of future profits are not exact in standard conditions and because of their uncertain character may be and are manipulated when applying for a grant. We demonstrate this case in two specific applications.

3.3 Research Results

In this part we provide concrete data documenting the purposes and the size of “deadweight spending” in selected region.

3.3.1 The Estimated Size of Deadweight Spending

Concerning the measurement of deadweight spending, our (non-representative) sample in Banska Bystrica region is 16 SMEs that applied for the support, met the criteria, but were not financed because of lack of resources. In all 16 cases (simplifying calculations and limiting the chance of mistakes) only “borderline” responses were provided – Table 3.1.

Table 3.1 Responses from SMEs with projects that were approved but not supported

	The project was realised without support	The project was not realized
Micro-enterprises	0	3
Small enterprises	2	6
Medium enterprises	0	4
No response	0	1

Source: own research.

Despite the fact that our sample does not allow for direct calculations of deadweight spending, the response clearly shows that for most cases applications for grants are submitted by SMEs proposing projects that are not sustainable without public grants, this means such a project would not be realised in “free market” conditions. We cannot say directly that these projects are also socially ineffective, because we are not able to calculate whether their alternative realisation would create enough direct and indirect benefits (multiplications) to make them socially effective, if realised. In any case they present examples of potentially ineffective proposals and their large proportion in our conditions indicates the large risk of “deadweight spending”.

3.3.2 Selected Problems with Calculating Financial Data for Projects

In this part we provide several examples clearly documenting the ways in which financial data describing proposed projects is manipulated for specific data from specific, but unnamed projects. Box 2 is the case where future revenues from services are over-estimated. Box 3 is a relatively similar case, documenting the manipulation of costs and revenue data to achieve the “necessary” level of profitability. Box 4 documents the importance of the discount factor and also some very visible manipulation of future predictions.

Box 3.2 Case 1: Firm XYZ

The goal of the project is constructing a small tourist enterprise – bed & breakfast (tourism is one of the main areas, where we feel that the substitution effect “creates” a lot of new ineffective projects – restaurants, hotels, pensions that cannot cover full running costs and survive only thanks to subsidized investment costs, without an evaluation as to whether such artificially created bodies are needed and sustainable).

The following assumptions were used in the project's financial analysis, leading to the conclusion that in 2019 all investment will be recovered:

A: Accommodation – 15 beds, price for the whole period 30 EUR/night. The utilisation rate is 40 % in the first two years, 50 % in the following two years and 60 % for the rest of the time.

B: Catering services – 45 permanent seats, revenues 5 EUR per place, utilisation 60 % over the whole evaluated period. 25 temporary seats on the summer terrace, revenues 4.15 EUR per place.

A closer look at these assumptions indicates (the building is constructed in the area with limited demand) that the input data has been accommodated to provide the planned results (in particular a 60 % occupancy rate for a small bed and breakfast is very unrealistic). Unrealistic assumptions are the basis for the proposed indicators in the template based Table 3.2.

Table 3.2 Template for the project's financial indicators

Financial indicators of the project								
Indicator	Unit	Year n	Base	Plan				
				n+1	n+2	n+3	n+4	n+5
Value added	EUR	2010	72 396	122 087	136 161	136 892	159 331	173 007
Revenues	EUR	2010	88 130	175 198	193 023	194 417	227 611	245 369

Source: project proposal of enterprise XYZ.

The financial indicators of the project provided by the manipulated template table are one of the bases for an evaluation carried out using the standard process (two reviewers delivering one joint review). They are a subpart of the summary table for the financial part of the project (Table 3.3) representing 15 % of the project's total score (Table 3.4).

Table 3.3 Template: Evaluation of the financial part of the project

	Criterion	Weight	Points	Weighted points	Source of data
3.	Financial data				
3.1	Quality and structure of budget.	1	0 - 4	x	x
3.2	Are planned costs eligible costs?	0.75	0 - 4	x	x
3.3	Is budget connected with realisation phases of the project?	1	0 - 4	x	x
3.4	Relation between revenues and costs	1	0 - 4	x	Table “Financial indicators of the project”

Source: Operational Programme.

Table 3.4 Template: Final evaluation table

Total score				
	Meta-criterion	Maximum	Achieved	(%)
0	Eligibility	A	X	x
1	Feasibility of the project	40	X	x
2	Realisation of the project	10	X	x
3	Financial data	15	X	x
4	Capacity of applicant	10	X	x
5	Sustainability	25	X	x
Total:		100	X	x
Minimum to be achieved		78	X	78 %

Source: Operational Programme.

Our case clearly indicates that manipulation of future estimates may be crucial for the success of the proposal – both to obtain the minimum score and to obtain the maximum grant. Such creative manipulations may be evident, but it is difficult to prove them, thus without doubt we can prove that the evaluation process system is not resistant to important substitution effects.

Box 3.3 Case 2: Firm ZYX

In this case we just provide financial data for another specific, but unnamed, firm producing goods and services and its project for new technology investment (Table 3.5 and Table 3.6). This case again demonstrates the limited validity of the data for profitability estimates.

Table 3.5 Project costs

		07/2009-12/2014				
B. INVESTMENT COST THOUSANDS EUR						
	2009	2010	2011	2012	2013	2014
Technologies	735.60	0	0	0	0	0
Investment costs total	735.60	0	0	0	0	0
C. RUNNING COST THOUSANDS EUR						
Item	2009	2010	2011	2012	2013	2014
Material	1370.9	1434.0	1497.0	1560.1	1639.8	1716.1
Energy	142.7	149.4	156.0	162.7	169.3	179.2
Salaries	318.7	331.9	345.2	358.5	371.8	385.0
Maintenance	59.7	63.1	66.4	69.7	73.0	76.3
Overheads	570.9	610.8	650.6	690.4	726.9	766.8
Running costs total	2463.0	2589.1	2715.3	2841.4	2980.8	3123.5
Depreciations	185.9	159.3	139.4	119.5	102.9	89.6
Full running costs	2648.9	2748.5	2854.7	2960.9	3083.7	3213.2
D. FINANCIAL COSTS THOUSANDS EUR						
	2009	2010	2011	2012	2013	2014
Credit base	663.9	531.1	398.3	265.6	132.8	0.0
Interest	11.6	25.2	19.6	13.9	8.3	1.7
Financial costs total	675.5	556.3	417.9	279.5	141.1	1.7

Source: project proposal of the enterprise XYZ.

Table 3.6 Project revenues and profitability

E. REVENUES THOUSANDS EUR

	2009	2010	2011	2012	2013	2014
Services	2 698.7	2 834.8	2 977.5	3 126.9	3 282.9	3 445.5
Goods	92.9	96.3	99.6	102.9	106.2	109.5
Revenues total	2 791.6	2 931.0	3 077.1	3 229.8	3 389.1	3 555.1

F. PROFITABILITY THOUSANDS EUR

Total costs	Own sources		External sources		Requested grant from OP	
735,6	71.8		663.9		367.8	
	2009	2010	2011	2012	2013	2014
Remaining costs	816.0	293.8	-21.5	-376.7	-778.4	-1 216.5
Balance	142.7	182.6	222.4	268.9	305.4	341.9
Repayment	0.0	132.8	132.8	132.8	132.8	132.8
I-(2+3)	661.6	-21.5	-376.7	-778.4	1 216.5	-1 691.2

Source: project proposal by enterprise ZYX.

The last column in the Table 3.5 is decisive for evaluating the application – see the text above. There are two ways of preparing the financial documentation for such a project – start from real figures and reach a dissatisfactory result in the last column, or start from the last column and adopt figures accordingly. Which approach would dominate in Slovak reality?

Box 3.4 Case 3: Firm YXZ

The last case focuses on the problem of the discount factor. For calculations of profitability the rules of the Operational Programme prescribe the discount factor be set at 5 % for all projects. This may be a good common base for evaluating the financial parts of submitted projects, but it is not an effective basis for assessing the real efficiency of public grants.

The firm plans to reconstruct and develop a bed and breakfast and asks for financial support from the Operational Programme, axis 3. Eligible costs (see case 2) are 352 168.39 EUR, the level of grant is 50 % (176 084.20 EUR). Table 3.7 includes calculations of future profitability (the problem of data manipulation is also visible here, as for the above mentioned projects – see the estimated costs in 2018). With a discount factor of 5 % the Net Present Value of the project is 4 131 EUR, profitability 1.36 % (too low...).

Table 3.7 Costs and revenues of the project without a discount factor

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Costs	150 000	54 285	28 285	28 285	31 135	31 135	31 135	31 135	- 41 865
Revenues	0	50 000	50 000	50 000	50 000	50 000	50 000	50 000	50 000
Profit	-150 000	-4 285	21 715	21 715	18 865	18 865	18 865	18 865	91 865

Source: project proposal from enterprise YXZ.

The use of a 5 % discount factor is not the best choice for calculating the real profitability of the firm. The second part of investment costs is covered by a commercial loan, with a 6.75 % interest rate. This means that the real discount factor will be higher and all financial estimates are invalid – a clear indication of the potential for the substitution effect (Table 3.8). With negative NPV the investment would hardly be financed from private sources even with a public grant. Such situation directly generates a question: What is the goal of application: future business or just to receive the grant?

As an addendum, in Table 3.9 we document the financial soundness of the project supposing that all investment costs will be covered without public grants. The data is calculated with a 5 % discount factor, to enable a comparison of results with and without the grant. They provide a clear example of the basis for the deadweight spending problem.

Table 3.8 Net Present Value of the project with public grant if discount factor is 6.75 %

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Costs	150 000	54 285	28 285	28 285	31 135	31 135	31 135	31 135	- 41 865
PV costs	140 515	47 637	23 252	21 781	22 460	21 040	19 709	18 463	- 23 256
Revenues	0	50 000	50 000	50 000	50 000	50 000	50 000	50 000	50 000
PV rev.	0	43 877	41 102	38 503	36 069	33 788	31 652	29 650	27 775
Profit	-150 000	-4 285	21 715	21 715	18 865	18 865	18 865	18 865	91 865
PV profit	-140 515	-3 760	17 851	16 722	13 609	12 748	11 942	11 187	51 032
NPV:	- 9185								

Source: data from the project proposal of the enterprise.

Table 3.9 Net Present Value of the project if financed privately – discount factor 5 %

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Costs	300 000	80 285	28 285	28 285	31 135	31 135	31 135	31 135	- 41 865
NPV costs	285 714	72 821	24 434	23 270	24 395	23 233	22 127	21 073	- 26 987
Revenues	0	50 000	50 000	50 000	50 000	50 000	50 000	50 000	50 000
NPV rev.	0	45 351	43 192	41 135	39 176	37 311	35 534	33 842	32 230
Profit	-300 000	-30 285	21 715	21 715	18 865	18 865	18 865	18 865	91 865
NPV prof.	-285 714	-27 469	18 758	17 865	14 781	14 077	13 407	12 769	59 217
IRR:	- 7.16								
NPV:	- 162 309								

Source: data from the project proposal of the enterprise.

This last case effectively documents the problems of the Operational Programme evaluation process. Improvements are necessary to limit the chances for large substitution effects.

3.4 Conclusions

The substitution effect is a common feature of both public revenues and expenditures. It must, inevitably, also be a part of the public grants provided by EU operational programmes, causing significant deadweight spending. To limit inefficiencies caused by this effect, the system of preparing programmes and selecting projects should be designed in the best possible manner.

Our case study provides evidence about selected aspects relating to the substitution effect of implementing the Operational Programme Competitiveness and Growth in Slovakian conditions. The information collected indicates that the system of evaluation is not well designed and provides room for large substitution effects. Moreover, inputted data is frequently manipulated without any consequences. The situation should be improved in the future to limit inefficiencies and also to increase fairness and transparency.



4

CROSS-BORDER COOPERATION OF SMALL AND MEDIUM-SIZED ENTERPRISES ON THE POLISH-CZECH BORDER

Cross-border cooperation is now one of the most important issues concerning the European Union. Through the European Fund system the EU finances reductions in border-region disparities at the social and economic level. But supporting cross-border cooperation is also important for the EU for other reasons such as environmental protection. Spatial problems are borderless. Solving these problems becomes more and more important and it is increasingly raised in EU structure. As a result we can point out documents concerned with such issues such as: the European Spatial Development Perspective and the Green Paper.

The aim of this chapter is to identify significant economic aspects of Czech-Polish cross-border cooperation for small and medium enterprises, to define new opportunities and obstacles to this cooperation. The impacts of EU funds on these enterprises were researched and identified as was whether and how these finances impact Czech-Polish cross-border cooperation. The methodology of data collection used was:

- standardized interviews and questionnaire research within group of representatives of Czech and Polish SME
- a workshop where the SME's representatives were invited along with representatives of the Czech and Polish commercial chambers, the Czech-Polish commercial chamber, representatives of the operational program Cross-border Cooperation Czech Republic – Poland, as well as university professors and students interested in this topic.

4.1 Characteristics of the Polish-Czech Border Region

After the fall of the communist regimes in Central and Eastern Europe, when the free market was introduced and transformation process started, the main result for these regions was many local factories and other enterprises that were not able to survive in the new conditions closed down. It happened in many regions in post-communist countries, but the problem in the Czech-Polish cross-border region was a lower level of investments in comparison with e.g. the Czech-German border regions (Houžvička, 2003).

For the purposes of this paper the border region means the Liberecký, Královéhradecký, Pardubický, Olomoucký and Moravskoslezský regions in the Czech Republic and the Dolnoslaskie, Opolskie and Slaskie regions in Poland. The regions where the survey was carried out can be seen in Map 4.1 (circle). In the Czech Republic the above mentioned regions are at the NUTS 3 level. Together the Liberecký, Královéhradecký and Pardubický form NUTS 2 Severovýchod., the Olomoucký region with the Zlínský region (which is not characterized as a border region with Poland) form NUTS 2 Střední Morava, the Moravskoslezský region is both a NUTS 3 and NUTS 2. The Polish regions are characterized as NUTS 2. For this paper the border regions means those regions included in the Operational Programme Cross-Border Cooperation Czech Republic-Poland. These regions are divided into smaller administrative units (districts) in both countries.

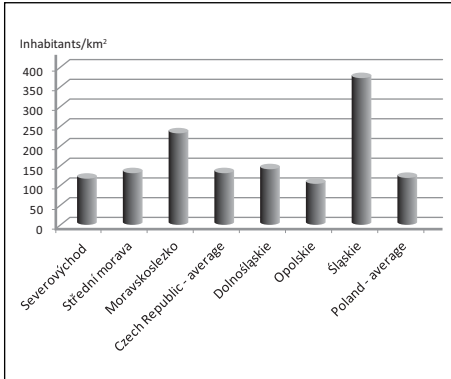
Map 4.1 Czech-Polish border region and districts, where the empirical research was done (circle)



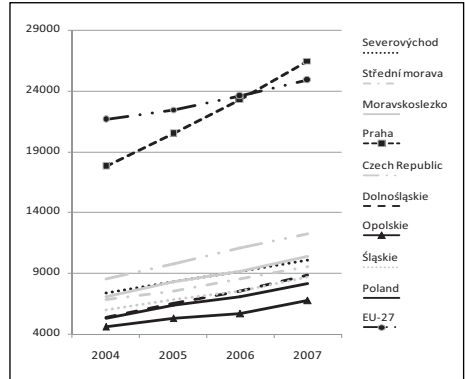
Source: Research of the authors and www.cil3.cz.

For many centuries this cross-border area was settled by a mainly German population. After the Second World War these people left because of the changed political situation and new inhabitants moved in. This new population came from the former Eastern Poland, which had become part of the Soviet Union after the war; in the case of Czechoslovakia the new population came from all over the country, there was no change of borders. For a long time these new inhabitants were not sure if this situation would last “forever” and this determined their attitudes towards their new home.

Today more than 12 million inhabitants live in the Czech-Polish border region. 3 375 000 in the Czech Republic – representing 32 % of the total Czech population and 8 774 000 in Poland, which is about 23 % of the Polish population. The population density in most NUTS 2 border regions is similar to the national average. Only in the NUTS 2 regions Moravskoslezsko and Slaskie is the density higher (see Graph 4.1). These regions are traditional industrial areas and one of the economic centres of the countries. The area of the border region on the Czech side of the frontier is 23 157 km² (29.36 % of total area) and on the Polish side of the frontier it is 41 654 km² (13.32 % of total area of Poland). The Czech Republic and Poland have 796 km of common frontier.

Graph 4.1 Population density in border regions (level NUTS 2)

Source of data: Eurostat.

Graph 4.2 GDP per inhabitant (EUR) at current market prices at NUTS 2 level

Source of data: Eurostat.

The economic situation on both sides of the border looks quite similar. The GDP per capita is slowly growing. The Czech regions are slightly more economically active and in 2007 the per capita GDP in all three Czech NUTS 2 regions was more than 10 000 EUR. Nevertheless, the per capita GDP in these regions is lower than the average for the Czech Republic. The relatively high average per capita GDP is caused by the extremely high GDP of Prague, which is even higher than the EU-27 average (see Graph 4.2). The Polish border regions create lower per capita GDP than the Czech ones, but even so two of them (Śląskie and Dolnośląskie) are above the average of Polish GDP per capita. Only the Opolskie region (with a per capita GDP of 6800 EUR in 2007) is below the average for Poland and it is the poorest NUTS 2 region of all the regions analyzed.

4.2 Cross Border Cooperation

4.2.1 Borders and their Function

Different communities naturally try to separate themselves from one another; on the one hand to demonstrate their individuality and on the other to ensure safety (Gorzelać, 2007). As such the border has become an element that is shared. It has become an inseparable element of statehood and territoriality. Its existence is justified by the military, fiscal, legal, or ideological functions. A designated area is controlled by the authorities, and thus becomes the sphere of socio-economic impacts. Border opening or total removal can mean a loss of power and influence. The implication of maintaining national borders is disrupting the processes of economic, social and cultural rights (Kopczewska, 2008). In practice, there are many concepts relating to the border, an example might be the terminology in the English language for example (Kopczewska, 2008):

1. *Boundary* – this means the line designating the extent of the State

2. *Limit* – usually covered with foreign countries and means a line designating the range of administrative power,
3. *Barrier* – means the boundary which is an obstacle, created to delay or prevent the free movement of goods, services, capital, labour and knowledge,
4. *Frontier* – designated as a boundary or peripheral areas, which are situated far from the centre,
5. *Border or border region* – these terms have a double meaning. It is a region which has no clear defined framework. However, this often means the area along the border, a border region.

Types of boundaries involve the operation of various forces. Open borders correspond to the arrangement of centrifugal forces, especially the border regions. This results in the region having frequent contacts with its neighbours, cross-border economic and social interactions. Then a border becomes the boundary line of contact, which is a meeting place for neighbours and transactions, rather than a line of demarcation that separates the countries or regions.

Closed borders work in the opposite way, for example a boundary that separates the borderland of neighbours outside the border, and thus force the contacts of the border regions to interact with the regions inside the country. They cause centripetal forces (Kopczewska, 2008).

Open borders encourage centrifugal forces, but this does not happen at every level. They may influence social interactions, economic and business processes. However, they are limited by domestic policy, which has the characteristics of centripetal forces. A high level of centralized decision making leads to the involuntary alienation of the border.

Transfers of decision making to the regional level lead to a change in the forces system. The boundaries of the border or frontier on which the action of centrifugal force can be considered as part of a binding element is reflected in the meaning of borders as zones of contact. The boundaries (boundary type), causes centripetal forces and are separating element. It results in borders, which constitute a barrier to interaction and development (Kopczewska, 2008).

Currently, the boundaries can be viewed as a special place in space where there are simultaneously two opposing processes, integration and isolation, cooperation and exclusion. On the one hand the boundary is a barrier limiting development due to difficulties in sharing economic and cultural resources. It is also a determinant of the identity and nationality of the region's inhabitants (Gorzalak, 2007). Boundaries also impede the flow of ideas, information, etc., causing a displacement discontinuity in diffusion (Kopczewska, 2008). On the other hand, it is a source of locational advantage, which may stimulate the development of local centres, due to resources occurring on one side of the border not being exchanged. Proximity to the border makes access to such resources easier (Gorzalak, 2007).

The primary factor that enables cooperation and contacts between the inhabitants from the border regions – is the border's permeability (Gorzalak, 2007). The permeability of borders is closely linked with another classification of borders: open borders and closed borders.

Open borders correspond to the arrangement of centrifugal forces, particularly for border regions. This means putting the region in contact with foreign neighbours, cross-border social and economic interactions. The boundary then becomes not a line of de-

marcation separating the two countries or regions, but a line of contact, which is a meeting place for neighbours and transactions (Kopczewska, 2008). On the contrary, closing the borders forces regions to interact with the regions inside the country along the border (Kopczewska, 2008). They trigger centripetal forces. In practice, fully open or fully closed boundaries don't exist.

Opening the border is usually used to move the regions involved from a state of alienation towards integration (Kopczewska, 2008). Fields which are located on both sides of the border can be transformed (under favourable conditions) from the peripheral areas in core systems. The evolution of peripheral areas has a historical character and is determined by certain socio-economic and political conditions associated with this level of formalizing the border (Przybyła, 1995). This is connected with the availability of the road and border infrastructure and the border regime and, therefore, any rules relating to crossing the border (Gorzelak, 2007). .

Nowadays, global processes are observed, in particular the network economy, which is a special case of international cooperation at the regional level. Thanks to the network economy, the border regions have the opportunity to create cross-border links and benefit, thereby increasing its potential for development. In this way a cross-border region can be created, which covers regions that lie on both sides of the border (Ciok, 1990). Under the new arrangements emerging in Europe the boundary had a chance to go abroad with the transformation of the dividing lines in the realm of intensive contacts (Ratti, 1993). In this way there was better access to the resources of the neighbouring country, in the form of capital resources, manufacturing, investment and human capital. There was also easier access to international markets, which in turn allows for diversification of sources of supply and sales. So in the end, the exchange of experience between regions is quicker and more effective.

To sum up boundaries, it is necessary to emphasize their main features. On the one hand, the boundaries are acting as barriers to the movement of goods, services and people and on the other hand, the modern boundaries serve a function of integration – as a framework for cooperation, such as cross-border cooperation. The European Union strongly encourages free movement (introduction of the Schengen Treaty), but also significantly supports cross-border cooperation through its funds.

4.2.2 Border Regions and their Cooperation

The issue closely related to the border is the border region. This is the area located at the state border (Przybyła, 1995). The state border unilaterally closes off border areas, determining the functioning and development of these areas (Falkowski, 2006).

In the literature, a border region is often identified with backward and poorly developed areas. This is due to geographical, economic and political factors, including the location of the defence industry and the specificity of military threats. In the case of Poland and the Polish border region, this is a historical approach (Wyrzykowski (Ed.), 2008). In the modern era of dynamic processes, the backward regions with a low level of social and economic development reached a high level of competition and rapidly evolved (Zagożdżon, 1980). This is especially visible, when the neighbouring states have a similar or the same socio-economic – political system and when they belong to the same international groups (Przybyła, 1995).

Benefits from a neighbouring location do not depend solely on the economic effects of growth, reducing costs, enhancing the exchange of goods, services and factors of production. Human relationships, the mutual penetration of cultures, are also important (Przybyła, 1995). Of paramount importance is the level of the border participants' involvement, their contribution to solving mutual problems. B. Winiarski (1979) called it "the depth of penetration." Depth is increased with a growth in contacts and growing co-operation. The "activity" and "passivity" of the border area can be distinguished, which also determines the level of contacts. The activity and passivity is connected with the number of functional border crossings.

The effect of developing cross-border cooperation is an area pin⁵. This area is created at the junction of several peripheral devices. With ever stronger economic ties, the administration of social barriers creates an integrated region (Rykiel, 1991). Cross-border cooperation is any joint action taken, that aims at developing and strengthening the neighbourly relations between territorial authorities and communities of at least two parties and it is a broader concept than euroregional cooperation⁶.

A euroregion is a kind of cross-border region. There is a high degree of institutionalization of cross-border cooperation structures, specialized bodies to coordinate such cooperation. Areas of euroregional cooperation are border fields, as well as the border area. Then there is the borderland, frontier and cross-border area. Another area of cooperation is the region, a border region, also called the border region and the frontier and cross-border region. Euroregion cooperation⁷ has the widest scope. On the Czech-Polish frontier there are 6 common Euroregions (Silesia, Těšínské Slezsko – Śląsk Cieszyński, Beskydy – Beskidy, Praděd – Pradziad, Glacensis and Nisa – Nysa – Neisse). Euroregion Nisa – Nysa – Neisse and Euroregion Beskydy – Beskidy are trilateral Euroregions (partners are the Czech Republic, Poland and Germany or the Slovak Republic). In the figure of the Euroregion Nisa – Nysa – Neisse (Map 4.2), the dark illustrated areas are municipalities that are included into the Euroregion, the white or bright areas are municipalities that are not included into the Euroregion.

The existence of the state border, which is a spatial barrier, has begun to blur over the past decade. Until WWII the boundary constituted a barrier to the flow of capital, transport, energy exchange, or other elements of infrastructure. Moreover, the language was a dividing line. The local and regional authorities acting on the sides of the border also had different competences. They had different concepts of the spatial development of border areas. Particularly noticeable were the differences in the potential of the natural environment. This led to various conflicts and disputes (Stolarz, 2009). All state power has primarily focused on developing the centre of the state. Border regions were considered as areas with a lower rank of importance, representing areas with lower development. These were mainly agricultural areas and even backward. Due to neglect by state authorities, which focused on developing the centre of the country, these areas were generally inhabited by an uneducated population. There was therefore no chance that border regions could have developed at the same pace and dynamic as the centre.

As a result of improved political relations and deepening economic cooperation, the border as a barrier became increasingly inconvenient, especially as concerns the border

5 contact area

6 for more information about cross-border regions and euroregions see <http://www.euroregion-tatry.pl>

7 <http://www.euroregion-tatry.pl>

Map 4.2 Euroregion Nisa-Nysa-Neisse



Source: Czech Statistical Office.

areas. The border, began to disrupt integration and business development. It began to affect people living in particular areas near the border. It inhibited the full development of frontier trade or tourism, and the development of transport systems (Stolarz, 2009). As a result of numerous protests, the state authorities began to pay attention to the problems of people living by the border. It was allowed to enter into various treaties and international agreements. It began to weaken the role of the border. It became easier for people and various products to cross. Tourism and border trade have also developed. In addition cross-border regions appeared, with their own budgets, bodies and institutions. Euro regions were created.

In Western European countries cross-border cooperation had developed long ago. In Central and Eastern Europe it started with considerable delay, due to the fact that the borders were previously closed. This meant that the policy of crossing borders had to be prepared more accurately and carefully placed. It had to take into account all aspects of human coexistence, regional and local differences in income levels and infrastructure. People had to develop a common historical and cultural awareness (Stolarz, 2009). It was not that simple.

Despite many attempts to approximate these regions there are still noticeable mutual prejudices and antipathy. This is due to these regions having different levels of development.

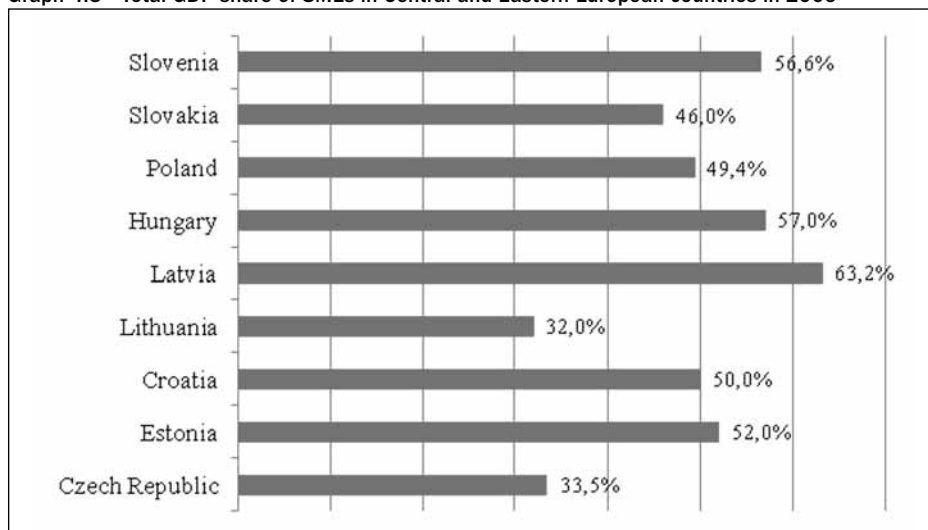
4.3 Small and Medium-sized Enterprises in Poland and the Czech Republic

Both in the literature and in practice, the primary role of the SME sector in the economy is clearly emphasized. SMEs are in fact a kind of stimulant for the development of the economy. Their number and potential in certain situations is one of the measures for assessing growth. Small businesses in any economy are a sign of healthy competition and reflect an entrepreneurial society. The sector of small and medium-sized enterprises is characterized by a dynamic approach to the environment. It is believed that these companies are able to quickly respond to the emerging needs and preferences of potential customers (Domański, 1992).

In Poland, the Czech Republic and in other new EU member states, small and medium enterprises play a dominant role in the economy (see Graph 4.3). Most important are SME for the economy of Latvia, Hungary and Slovenia (the SMEs share of GDP is about 60 %), but in Poland too the contribution to GDP creation is quite high (49.5 %). Historically the Czech Republic is a typical industrial country with a relatively lower share of GDP from SMEs (33.5 %). On the other hand in the Czech Republic SMEs represent 99.8 % of all enterprises and employ 66.2 % of all economically active people (SME Union Czech Republic [online]).

SMEs exert a significant impact on economic growth and their steadily increasing share in the economies has forced a new classification for micro, small and medium-sized enterprises. It is well known that the driving force for micro, small and medium-sized enterprises is their competitiveness due to a rapid response to external factors and an ability to immediately adapt to new market needs. Ranking a particular company into the sector of small and medium-sized enterprises is based on different criteria. Most are qualitative and quantitative criteria. The qualitative criteria emphasize the economic and legal autonomy of the business owner. It means that the owner is able to achieve their objectives in the company, at their own risk, with nothing being subject to inspection by third parties. This means that these companies are characterized by independence and freedom in decision-making. Such companies are the main source of livelihood for the owners and their family members. Very often they are also the main livelihood for its staff, which introduces a family relationship in the company.

Another feature of a qualitative description of small and medium enterprises is the specific nature of the financial management of these units. Creating a company is often based on the owners' savings and loans from relatives or friends. However, funding for the development phase of these firms is generally based on internally generated surplus, which often means the SMEs do not grow as fast as they could, precisely because of limited financial resources. Companies in this sector also have a limited ability to use financial instruments related to the capital market. They are only available to businesses with an appropriately high level of assets involvement and revenue generated. The qualitative feature of SMEs is their organizational structures – a few levels of management of small span, short-distance information flow, with, practically one central decision-maker. This type of structure (flat structure) increases the responsiveness to changes in the business environment, therefore, it may contribute to increasing the efficiency of its operation. In addition, it fosters flexibility and entrepreneurial behaviour, which generally favours increasing the

Graph 4.3 Total GDP share of SMEs in Central and Eastern European countries in 2009

Source: www.sme-union.cz.

company's market value. When it comes to extracting the quantitative criteria of small and medium-sized businesses, they are most likely to occur here:

- the volume of employment,
- the value of property,
- turnover.

In most cases, the leading criterion is the number of employees in the unit. Entities grouped by the criterion of the number of people employed, are in turn further divided by characteristics of economic potential, which may include: property, capital, marketing, financial performance, capital expenditures, etc. (Safin, 2003).

According to Polish law⁸: Sejm Resolution of 26 November 2004, which introduced amendments to the Law on Freedom of Economic Activity of 2 July 2004, the definition of micro, small and medium enterprises are as follows.

A micro-entrepreneur is an entrepreneur who in at least one of two financial years:

- employed on average less than 10 workers,
- achieved an annual net turnover of less than 2 million euro

A small entrepreneur is considered to be an entrepreneur who in at least one of two financial years:

- employed on average fewer than 50 workers,
- achieved an annual net turnover not exceeding 10 million euro.

A medium entrepreneur is considered to be an entrepreneur who in at least one of the two financial years:

- employed on average fewer than 250 workers,
- achieved an annual net turnover not exceeding 50 million euro.

⁸ According to Small and Medium Support Law (Law no. 47/2002) is the definition of micro, small and medium enterprises in Czech law similar to definition in Polish law

Therefore enterprises qualify as micro, small or medium-sized enterprises if they meet the maximum ceilings for staff and either a turnover ceiling or a balance sheet ceiling.⁹

4.4 Czech-Polish Cross-border Cooperation and EU funds

Access to the European Union allowed poorer regions from Central and Eastern Europe to use special pre-access funds for their development and, after 2004, to join the European cohesion policy for disadvantaged regions. The importance of this policy is shown by the fact that the cohesion policy is the second largest item in the EU budget, representing one third of the total sum (Varga and Veld, 2010). Nevertheless as Bachtler and Gorzelak (2007) state the results of the cohesion policy in new member states led to bettering metropolitan areas. Industrial zones, where the industry base had collapsed, were not able to develop a modern service sector let alone rural agricultural areas. What is more, Varga and Veld (2010) concluded, on the basis of a detailed GDP model analysis for 2000-2006, that significant results of the Cohesion Policy in less-developed EU regions could be observed in the medium or long-term.

On the one hand there are funds for supporting the SME sector but on the other hand we could observe an absence of systematic monitoring and methodology for evaluating the cohesion policy's effects. It is not only a problem in the Czech Republic or Poland, but in Central and Eastern European countries in general (Malan, 2005). The methodology is not so developed as in older EU member states. The second problem is the institutional background – evaluation is usually paid for the by subject being evaluated.

In the long-term Czech-Polish cooperation was / is supported from several sources:

- Operational Programme Cross-border Cooperation Czech Republic-Poland 2007-2013 (described in more detail in the next chapter),
- Cross-Border Cooperation Phare (1994-2004),
- Interreg III B CADSES.

Cross-Border Cooperation Phare

This program was established in 1994, its aim was to support of neighbouring states cooperation in cross-border regions and suppress the border's negative influence by stimulating the economic development and competitiveness of companies from this region, bettering the infrastructure, resolving old environmental problems etc. Between 1994 and 2004 over 220 million EUR was allocated here.

At the very beginning the program was aimed only at Czech-German and Czech-Austrian cross-border regions, from 1999 it also incorporated the Czech-Polish border region – the amount of finances allocated was 3 million EUR in 1999 and 5 million EUR each year up to 2004. The program had different funds for big investment projects and for small projects with less complicated administration.

Interreg III B CADSES

This program is, in general, focused on transnational cooperation. For this purpose Europe is divided into 13 spaces. The biggest one is the Central Europe, Adriatic, Danubian,

⁹ Commission staff working document on the implementation of Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises. Brussels, 7. 10. 2009, p.2-3.

South-Eastern European space (CADSES) – it includes 18 countries. It supports cooperation at every administrative level (central, regional and local) between EU members and EU non-member countries in the border regions. After the Central European countries joined the EU, CADSES was transformed into the Neighbourhood program.

Interreg III B CADSES had 4 priority axes:

- Promoting spatial development, approaches and actions for social and economic cohesion,
- Efficient and sustainable transport systems and access to the information society,
- Promotion and management of landscape, natural and cultural heritage, Environmental protection, resource management and risk prevention.

4.5 Analysis of Czech Operational Programmes Relevant for Supporting SMEs in Border Regions

Currently there are three Operational Programmes in the Czech Republic that could have a more significant impact on SMEs development in the border region with Poland. These programmes are:

- Operational Programme Enterprise and Innovations (OPEI) 2007-2013,
- Operational Programme Human Resources and Employment (OPHRE) 2007-2013,
- Operational Programme Cross-Border Cooperation Czech Republic–Poland 2007-2013.

Operational Programme Enterprise and Innovations (OPEI) 2007-2013

OPEI is focused on enterprise subjects, mainly on small and medium enterprises. This program is financed by the European Regional Development Fund and is managed by the Ministry of Industry and Trade of the Czech Republic. 3.04 billion EUR has been allocated for 2007-2013 for the Czech Republic. OPEI has six priority axes:

- Establishment of firms,
- Development of firms,
- Effective energy,
- Innovation,
- Environment for enterprise and innovation,
- Business development service,
- (Technical Assistance).

The potential impacts of OPEI for firms in frontier regions are: improvement of competitiveness of the SMEs sector in frontier regions (implementing new technologies, upgrading the business infrastructure or increasing human potential).

Operational Programme Human Resources and Employment (OPHRE) 2007-2013

This programme is focused on reducing unemployment and an active policy on the labour market. This programme is also relevant for SMEs, which could apply for grants from the position of an employer. OPHRE is financed by the European Social Fund and is managed by the Ministry of Labour and Social Affairs of the Czech Republic. 1.84 billion EUR has been allocated for 2007-2013. The priority axes are:

- Adaptability,
- Active labour market policy,
- Social integration and equal opportunities,
- Public administration and public services,
- Transnational cooperation.

The first two axes are relevant for entrepreneurs. The potential impacts of OPHRE for firms in frontier regions are: employers' competitiveness, and hence the competitiveness of the firm, could be raised through requalification and improving human resources.

Operational Programme Cross-Border Cooperation Czech Republic – Poland 2007-2013

This operational programme is relevant for regions, municipalities, Euroregions, governmental organizations, NGOs, R&D institutions, Chambers of Commerce etc. but not for entrepreneurs.

EUR 219.49 million has been allocated for this operational programme.

It is focused on improving the transport accessibility of cross-border regions, environmental protection, supporting economic collaboration, supporting an improvement in the cross-border infrastructure and tourist industry services, supporting education, cultural and social activities, collaboration between municipal authorities and other subjects on both sides of the frontier.

The priority axes are:

- Reinforcement of Accessibility, Environmental Protection and Risk Prevention,
- Improvement of Conditions for Business Environment and Tourism Development,
- Support of Cooperation between Local Societies,
- (Technical Assistance).

Within the second priority axis Improvement of Conditions for Business Environment and Tourism Development, the most successful projects¹⁰ were:

- building of cycle trails in cross-border regions,
- creating cross-border information materials about tourist attractions in the region,
- creating innovative portals and contact centres.

These types of projects were carried out within other priority axis:

- improvement of fire-brigades,
- cross-border collaboration of rescue services.

All programmes considering cross-border collaboration are relevant for 5 regions in the Czech Republic (Liberecký kraj, Královehradecký kraj, Pardubický kraj, Olomoucký kraj and Moravskoslezský kraj) and their 24 districts. In Poland these programmes are relevant for 3 regions (Województwo dolnośląskie, Województwo opolskie, Województwo śląskie) and 38 districts (see Map 4.1).

The Operational Programme Cross-Border Cooperation Czech Republic – Poland 2007-2013 carried on from the programme INTERREG IIIA 2004-2006.

Interreg IIIA 2004-2006

The aim of this programme was to increase the overall socio-economic level of frontier regions regarding the commercial, economical, tourist and cultural interrelations

¹⁰ in most cases financially supported projects

between neighbouring regions. This programme was realised in 2004-2006 the goals of the programme were:

- increasing economic integration at the Czech-Polish frontier,
- improving conditions for the economic growth of the cross-border area,
- improving conditions for sustainable development of the environment and/or regeneration of the cross-border area,
- further social integration of the Czech-Polish frontier.

Mostly “hard” projects – investment into transport infrastructure – were realised from this programme.

The Operational Programmes in Poland are similar to the Operational Programmes in the Czech Republic and they have comparable potential impacts on small and medium-sized enterprises in Poland.

4.6 Methodology for the Empirical Research and Results

The main aim of the project was to identify the most important economic aspects of Czech-Polish cross-border cooperation for small and medium-sized enterprises. For this reason the research was carried out on both the Polish and Czech sides. A simple methodology was chosen for the research because of the very short duration of the research project and because of the clear interpretability of the selected data. First of all a short questionnaire was sent to small and medium-sized enterprises by e-mail. 679 questionnaires were distributed during the empirical research. In Poland 368 companies were asked to answer from the following districts: Zgorzelec, Luba , Lwów, Jelenia Góra, Kamienna Góra, Wałbrzych, widnica, Dzierżonów, Zbkowice and Kłodzko. These districts are indicated on Map 4.1. The questionnaire was sent to 311 companies from 13 districts in the Czech Republic: Karviná, Jeseník, Bruntál, Opava, Ostrava, Šumperk, Náchod, Rachnov nad Knžnou, Ústí nad Orlicí, Trutnov, Liberec, Jablonec nad Nisou, Semily (see Map 4.1).

The companies came from the following branches:

- automation, industry, metal processing,
- construction, mining, window frames
- energy, heating, measuring devices,
- business environment institutions,
- furniture, joinery,
- automotive, transportation, freight forwarding,
- packaging,
- printing, advertising, office supplies,
- training, consulting, advisory,
- textiles,
- IT services
- jewellery manufacture.

This questionnaire included three questions: (1) Does your company work with the Czech/Polish side? (2) Does your company use or benefit from any European Union

grant? (3) Has your company used EU funds in cooperation with the Czech/Polish side? There was a low response to the questionnaire (about 3 % in the Czech Republic and 0 % in Poland), so then a telephone survey was carried out among SMEs, during which 3 Polish and 3 Czech companies were found that cooperate with a partner on the other side of the border. Later on, an extended oral interview with the representatives of the companies that cooperate with the Czech/Polish side was conducted. Also the institutional foundation of Polish-Czech cooperation associated with the use of European Union funds was examined. This method of communication did not seem very efficient; it is necessary to find another channel of communication and change the methodology for future research (e. g. closer cooperation with regional business chambers).

The extended survey was more complicated and consisted of three parts:

1. general information,
2. direct support from the European Union's Fund,
3. indirect support from the European Union.

During the empirical research there were also two oral interviews with representatives of two provincial Chambers of Commerce in the Czech Republic (in Jablonec nad Nisou and Náchod). During these interviews information was obtained about practical experiences with projects, financed by EU Funds, whose aim is to support business development in the Czech-Polish border region.

Results

After the initial research 3 enterprises were chosen. An in-depth interview was carried out with these this 3 firms. The table below shows some of the main information about the enterprises.

Table 4.1 Main information from the survey in Poland

POLAND	Firm A	Firm B	Firm C
Company size	small	medium	small
Market activity	10 years	more than 10 years	5-9 years
Headquarters	kłodzki district	wrocławski district	Wrocław
Business area	sale and installation of windows	manufacture and sale of stainless steel exhaust pipes	sale of automotive air fresheners mainly to retail chains
The form of cooperation with the Czech Republic	export products, the branch	export/import products	import products, the branch
The way to make contact with the Czech Republic	internet, independent search for partners	Beskidzki Dom Maklerski	personal contact
Time of cooperation	5 years	1 year	5-9 years
Frequency of contacts	constant	constant	constant
The share of co-operation in trade with the Czech Republic	around 50 %	around 10 %	over 50 %
Language of communication	Czech, Polish	Polish	English
Satisfaction with the cooperation	yes	yes	yes
Plans to extend cooperation	yes	yes	yes
The biggest barrier in cooperation with the Czech Republic	difficulties in download payment	adjusting the business to Czech market requirements	language barrier, poor orientation in the Czech conditions and customs

Source: own survey.

General conclusions after research on Polish side of the border:

Two of the companies surveyed in Poland have not applied to obtain subsidies from European funds. This also considers funding for programs of cooperating with a foreign partner. The reason for this situation is that these companies indicate a lack of information about the possibilities of this type of support. One of the companies gained a support within the Sectoral Operational Programme Improvement of the Competitiveness of Enterprises. The grant had an impact on cooperation with the Czech Republic through the European patent trademark, which contributed to the dissemination of the trademark in the Czech Republic. Basic advantages of obtaining the grant: a positive impact on business development, particularly with regards to the financial aspect. Major disadvantages of obtaining a grant: complicated application procedure, lack of concentration on the aim of the proposal but only on the possible errors, long process of assessing applications, complicated form (which requires patience). None of the surveyed companies have benefited from EU funds indirectly (through training, participation in fairs and other events financed by the EU). Among the companies interviewed only one is a member of professional organization, the activities of this organization were evaluated positively. None of the companies indicated that the use of European Union funds in their immediate surroundings (such as building roads co-financed by the municipality and the EU) has contributed to changes in the functioning of the company, including cooperation with the Czech side.

Table 4.2 Main information from the survey in the Czech Republic

CZECH REPUBLIC	Firm A	Firm B	Firm C
Company size	medium	small	small
Market activity	more than 10 years	more than 10 years	more than 10 years
Headquarters	district Šumperk	district Jablonec nad Nisou	district Jablonec nad Nisou
Business area	manufacture of measuring and control equipment	import and distribution of wiring material	technical and business consultancy, organizing the certification of products manufactured in Poland
The form of cooperation with Poland:	export products	import products	import products, the branch
The way to make contact with Poland	trade fairs, internet	trade fairs, Internet	personal contact
Time of cooperation	more than 10 years	5-9 years	more than 10 years
Frequency of contacts	constant	constant	constant
The share of co-operation in trade with Poland	around 10 %	less than 10 %	over 50 %
Language of communication	Czech, Polish	Polish	English
Satisfaction with the cooperation	yes	yes	yes
Plans to extend cooperation	yes	yes	yes
The biggest barrier in cooperation with the Poland	language barrier	low competitiveness of Polish products on Czech market	different legal enactments (business law etc.)

Source: own survey.

General conclusions after research on the Czech side of the border:

The most common ways to find a partner from the other country are trade fairs and also the Internet. According to the respondents, trade fairs are the most effective way to find

a partner. The fairs are often organized within some projects financed by EU Funds (see below). The personal contact, direct communication as well as visual advertising of the product accompanied by verbal comment are the most important factors for establishing a partnership with firms from different countries. Barriers to deeper collaboration with the Polish partner are (according to the respondents), at most, the language barrier.

Czech and Polish are quite similar but the technical vocabulary is very different. That means that the partners are able to communicate about the basic problems but not about some specifics. This problem also occurs using English or German. Most of the forty and fifty-year olds in the Czech Republic and Poland, who are generally the owners or directors of enterprises, do not speak foreign languages very well. Another barrier is the different legal environment in both countries. The commercial law is not very well known by partners in other countries and this is a barrier to establishing a new firm or affiliated company there. For firms that are importing Polish products to the Czech market the dubious quality of Polish commodities is quite a serious barrier to deeper cooperation and therefore they are not able to compete with products made in other countries, mainly with domestic products. On the other hand Polish commodities are often much cheaper than commodities from other countries, this is a big advantage for them.

None of the firms interviewed in the Czech Republic applied for any type of grant through some Operational Programme or other source of European financial grant system. The two main reasons for not trying to get support from EU Funds were: The complicated processes of applying for a grant and afterwards the bureaucratic agenda connected with administrating the project is expensive for the firms. The second reason was that the firms only had little or no information about EU Funds.

For the 2007-2013 period one firm is a beneficiary of a project from the Operational Programme Human Resources and Employment. In this project employees from several firms in the Liberecký kraj (region) are taught Business English. So this firm benefits from EU funds indirectly. This type of project could have quite a high impact for further expanding collaboration between Czech and Polish enterprises, because the language barrier is one of the most serious ones. Only one of the companies on the Czech side of the border saw some positive impacts on the firm due to funds from the European Union used for investment into infrastructure. This firm produces street lighting. This type of investment is mainly made by municipalities and is often supported from EU Funds. So the turnover of this firm increases with more investment into the transport infrastructure. The enterprises are not eligible to apply for support from the Operational Programme Cross-Border Cooperation Czech Republic-Poland, they are only eligible for sectoral Operational Programmes as OPEI, OPHRE etc.

Cases of projects financed by EU Funds that should support business development in the Czech – Polish border region

The provincial Chamber of Commerce in Jablonec nad Nisou is a member of the project: “Creating a Network of Contact Centres for Czech – Polish Economic Collaboration” which is financed by the Operational Programme Cross-Border Cooperation Czech Republic – Poland 2007-2013 (budget 798 008 EUR).

Other partners (contact centres) of this project in the Czech Republic are the district Chamber of Commerce in Jeseník, the regional Chamber of Commerce for the Královohradecký kraj and Moravskoslezský kraj and in Poland the Karkonoska Agencja

Rozwoju Regionalnego, Izba Przemysłowo- Handlowa Ziemi Kłodzkiej and Sudecka Izba Przemysłowo-Handlowa w Świdnicy.

One of the results of this project is the publication of Czech commercial law in Polish and Polish commercial law in Czech, which should simplify the business activities for small and medium enterprises. In addition trade fairs have been organised, where Czech and Polish SMEs have the possibility to meet each other. The contact centres also broker the demand and supply among firms, give information about the mandatory information policy, state subsidies etc.

The district Chamber of Commerce in Náchod is a leading partner of a project called “Business Without Borders. Polish – Czech Internet Economic Portal”. This project is financed via Euroregion Glacensis by the Operational Programme Cross-Border Cooperation Czech Republic-Poland.

The portal gives businessmen information about establishing and operating an enterprise in Poland and the Czech Republic. One part of this web portal is a “cooperative market/exchange”, which is a database of enterprises from the frontier region. The portal also has a web notice board where firms can place offers, requests and job offers.

Box 4.1 Good practice

Good practice – creating a common Czech-Polish business

A Czech producer of drug-store products was invited to collaborate with a Polish producer of similar (not the same) products. They floated a company in 2002 – each partner had a 50 % share in it. Both mother companies are producers so they use this daughter company to gain advantages from two markets – Czech and Polish. They use this company to find common cheaper suppliers and obtain economies of scale. At fairs and these types of marketing presentations they can be represented at one stand. If one of the partners succeeds in getting his products to a store-chain in one country, it is a good reference to get the product to the same chain in the second country (the only condition is good price coordination). It helps them to enter the market in both countries. Representatives of both companies also meet to exchange experience, discuss problems in production processes, develop new products etc. Bilateral trust is important. Then cooperation can be profitable, brings benefits for both companies and helps them to face the market pressure to produce cheaply and efficiently

4.7 Conclusions

In a globalizing world we can observe changing factors of social and regional development. To be more competitive as a country or cross-border region it is more important to cooperate instead of competing. Countries and theirs regions tend to increase cross-border cooperation mainly by realizing common initiatives such as social events, festivals, but also building roads, railways and infrastructure in general. But the companies, especially small and medium sized ones, need to build this cooperation with the neighbouring side on their own. In cross-border regions we can find some institutions that support cooperation between Polish and Czech companies such as different chambers of commerce, foundations and other institutions. But still their activities are not satisfactory. That is why it was so hard to find companies cooperating with Czech/Polish enterprises.

After conducting this research we can form some general conclusion to the cross-border region. In the cross-border region an intensive growth in cooperative activities with institutions on the other side of frontier can be observed, but this cooperation is not yet reflected in a satisfactory cooperation of the economic units (SMEs). On the other

hand there are still barriers, such as a different legal background in both countries and the language barrier. Resources from EU funds play a large role in the activation of public and social institutions, however, it is insufficient to use these resources to enhance cooperation between the institutions. The firms in a cross-border region do not try to get financing from EU funds very often. Several firms participate in some projects organized by external institutions (projects like *teaching business English for employees of firms in a certain region*), but usually the firms are reluctant to draught their own project proposals.

The empirical research showed some important facts as to why the enterprises are not willing to draw up a project and then realize it. The main problem with projects financed by EU Funds is the huge administration. Drawing up project proposals, meeting all the bureaucratic requirements and managing all the confirmations, time sheets, monitoring reports etc. is very encumbering for the enterprises and, de facto, creates a need to hire additional administrative staff. These facts raise the personnel costs of firms and they are not highly motivated to try and apply for projects from operational programmes or other EU Funds. Another type of barrier to getting funding from EU Funds is the quite low level of awareness about the possibilities offered by funds. During the empirical research, a high proportion of company representatives mentioned, that they have no or little information on where to apply, if the firms are the relevant recipients of the support etc. Other enterprises are against any type of external subvention in principle and they mentioned that supporting selected firms from EU funds distorts healthy economic competition.

In general it is impossible to make any conclusions at this moment, as to whether European cohesion policy somehow helps to develop business in the cross-border regions. In fact this type of support has been used for a very short time. The institutions were only able to use these financial subvention mechanisms to a greater extent since 2004 (2004-2006 was the transition period for new EU member states, the first regular period has been running since 2007). More relevant results can be gleaned after a longer time period.

5

LESSONS LEARNT FROM THE UTILIZATION OF EU STRUCTURAL FUNDS THROUGH THE CASE OF NORTH HUNGARY, WITH SPECIAL REGARD TO THE ECONOMIC DEVELOPMENT

5.1 Concept of evaluation of regional development

The analysis and evaluation of economic policies, especially those of a regional aspect is one current research area of economics. This focus is connected to the issues of regionalisation, regional convergence-divergence and absorption capacity in the case of those countries that joined the European Union (EU) in 2004 and in 2007.

The county is the traditional mezzo-level state administration unit in Hungary; historically examples can not be found for NUTS 2 type regions (for the purpose of the EU Cohesion Policy) – apart from some short periods. However, in 1997 Hungary created a network of regions in order to meet the EU requirements. No local governmental functions have been associated with this level, instead the functions tend to be developmental, statistic and, to some lesser extent, state administration roles in the recent past.

Apart from the sectoral programmes, the National Development Plan (2004-2006) has had a geographically non-specified Regional Operational Programme. The New Hungarian Development Plan (2007-2013) already contains seven individual regional operational programmes for the current planning period. Therefore, North Hungary has also had a chance to utilise a share of the European Union funds, along its own system of goals and priorities (the North Hungary Operational Programme).

2010 offers an opportunity to evaluate the Action Plan 2007-2008 (AP 2007-2008), i.e. the first two years of the period. The reckoning may provide valuable and useful information for further developments up to 2013, despite the shortness of the period analysed.

The current research review about the Action Plan for the years 2007-2008 reflects the status of the third quarter of 2009.

5.2 North Hungary as a Target Area

North Hungary consists of three counties, namely: Borsod-Abaúj-Zemplén, Heves and Nógrád. The region is bordered to the north by the Slovak Republic, to the west by Central Hungary and from south and east by the Northern Great Plain.

Following the collapse of the socialist planned economy and that of COMECON in 1989-1990, the economy of the region fell into a serious crisis. The region became one of the losers of the transformation. The changes in the geopolitical situation, the out-of-date production system, the labour market structures and the underdeveloped infrastructure made it difficult to attract Foreign Direct Investment (FDI), widen export activities, and thus modernise the economy.

Map 5.1 Map of North Hungary



Source: authors' compilation.

After the accession to the European Union, the situation only improved slightly; the number of businesses with foreign involvement is still the lowest in a national comparison (in 2007: 733 units) and the FDI per capita is also among the lowest (in 2007: 1 518,7 EUR, i.e. 381 900 HUF)¹¹.

Table 5.1 Main parameters of North Hungary

Name of counties	Surface (km ² , 2009)	Population (person, 2009)	GDP (2007)		GDP per capita (2007)	
			Billion HUF	%	Thousand HUF	EU27 = 100 %
Borsod-Abaúj-Zemplén	7 250.0	701 160.0	1 186.9	4.7	1 662.0	41.1
Heves	3 637.0	314 441.0	581.7	2.3	1 828.0	45.3
Nógrád	2 546.0	207 637.0	245.9	1.0	1 162.0	28.8
North Hungary	13 433.0	1 223 238.0	2 014.5	8.0	1 619.0	40.1
Hungary	93 027.0	10 030 975.0	25 408.1	100.0	2 527.0	62.5

Source: KSH Statistical Yearbooks 2008-2009.

In addition to the moderate foreign investments, the economic activity of the local population is also low. The number of registered businesses per one thousand persons is the lowest among the regions in Hungary. In 2008 there were 113 as compared to the national average of 156. As a result of all this, labour market conditions are among the most unfavourable not only nationally, but also in comparison with the European Union.

11. The applied exchange rate equals 251.46 HUF/EUR, which is the average rate by the ECB for the period from 01. 01. 2007 to 01. 01. 2009.

In 2008 the employment rate was 43.7 % (the national figure being 50.3 %), and the unemployment rate was 13.4 % (the national figure being 7.8 %).

The future economic prospects and competitiveness of the region are worsened by the fact that the number of research and development facilities (195 units in 2008) and the weight of expenditure (GERD: 0.34 % in 2008) are marginal in the economy of the region. At the same time there are 9 higher education institutions functioning in the region, exerting a considerable effect on the cultural, economic and professional life. The only university, located in Miskolc, has 7 faculties of engineering and social sciences.

5.3 The Action Plan 2007-2008 of the North Hungary Operational Programme

The North Hungary Operational Programme (NHOP) manages an amount of 1 063 204 222 EUR at the current price under its total period (2007-2013) with respect of its five priorities in all. 85 % of the amount (903 723 589 EUR) comes from grants by the European Regional Development Fund (ERDF) and 15 % (159 480 633 EUR) from national resources.

The total figure is more or less evenly distributed among the years, which results in a yearly budget share of 13 – 15 %. By the sums allocated in the financial tables of the NHOP, the Action Plan 2007-2008 (AP 2007-2008) has had 27.71 % (250 408 130 EUR) of the total funds for the period 2007-2013.

The overall objective of NHOP consists of two essential elements: on the one hand, improving the economic competitiveness of the region, and, on the other, reducing the territorial socio-economic differences within the region. In line with this, three specific objectives have been formulated:

- Improving the competitiveness of the economy making use of local resources and cooperation;
- Improving the capacity of tourism to produce income;
- Enhancing social cohesion and developing an attractive economic and residential environment.

The above are to be achieved by means of 20 measures grouped in to 5 priorities.

Table 5.2 System and budget of priorities and measures in the Action Plan 2007-2008

Name		Budget (Million EUR)
Priority 1: Creating a competitive local economy		151.96
1.1.1.	Development of regionally balanced industrial areas of regional and local significance	
1.1.2.	Development of businesses by means of consultancy	
1.2.1.	Establishment of clusters and corporate cooperation	
1.3.1.	Developing the innovation potential of the region	
Priority 2: Strengthening the potential for tourism		228.69
2.1.1.	Development of competitive tourism products and attractions	

Name		Budget (Million EUR)
2.2.1.	Developing the quality of commercial accommodation and services	
2.3.1.	Development of destination management	
2.4.1.	Development of business services for tourism	
Priority 3: Settlement development		391.88
3.1.1.	Integrated social urban rehabilitation	
3.1.2.	Settlement rehabilitation to increase functions	
3.1.3.	Settlement development supplementing rural development programmes	
3.2.1.	Protection of environmental values, environmental safety	
Priority 4: Development of human community infrastructure		143.32
4.1.1.	Development of fundamental and out-patient medical care	
4.1.2.	Development of rehabilitation, geriatric and medical care services	
4.2.1.	Development of social welfare services	
4.2.2.	Ensuring accessibility of facilities	
4.3.1.	Development of education and training	
4.3.2.	IT development of regional public administration and public service systems	
Priority 5: Development of regional transport		105.54
5.1.1.	Improving access by road	
5.1.2.	Development of community transport	
Total		1 021.39

Source: NHOP AP 2007-2008.

The full financial estimate of the first Action Plan of NHOP, as well as its distribution by priorities, has been modified several times. Re-groupings and re-allocations were required by the different proposal activities found among the priorities. The final amounts of the funds has been around 1 022 million EUR (257 billion HUF), the previous table gives the allocation by priorities.

Funds can be allocated to calls for proposals. In the period 2007-2008 twelve one-stage or first-stage – plus six second-stage-calls for proposals were announced. 92 % of the planned funds were announced by these calls. The calls announced made a total of 382.048 million EUR (95.278 billion HUF) available, which is 2.38 % of the GDP of two years of North Hungary.

Priorities 3 and 4 were given particular significance in terms of both the planned and the actual allocation of funds. These two priorities – with approximately identical shares – used up 60 % of the planned budget. The rest was shared between the three other priorities (1, 2 and 5) in roughly equal parts.

Looking at the actual (announced) figures, only minor differences can be found, the sole reason for which is that for Priority 3 the value of funds announced was 26 % smaller than the amount planned.

Table 5.3 Financial frames announced in the calls for proposals by priority (million EUR)

#	Name of priority	Plan			Actual	Actual/ Plan
		2007	2008	Total	2007 - 2008	2007 - 2008
1.	Creating a competitive local economy	38.372	15.585	53.957	53.957	100 %
2.	Strengthening the potential for tourism	52.322	4.394	56.716	56.716	100 %
3.	Settlement development	91.255	32.367	123.622	91.251	74 %
4.	Development of human community infrastructure	56.844	69.594	126.438	126.438	100 %
5.	Development of regional transport	No data		53.686	53.686	100 %
Total		238.793	121.940	414.419	382.048	92 %

Source: authors' own compilation using EMIR database (downloaded in 3Q of 2009).

(The budget does not include the costs for the renewal of 4- and 5-digit roads implemented in the framework of regional road development connected to Priority 5.)

The calls in the period investigated generated a total of 1 672 registered proposals, most of which – close to half the total number – came in answer to Priority 4, with a great interest in Priority 3 too. Approximately 85 % of the proposals were submitted to the calls for these two priorities.

In terms of legal form (on the basis of the five priorities) the activity of local governments takes prime position with an 80 % share. The reason for that is partly the nature of the call, and partly the efforts of the local governments to obtain funds (which understandably increased their activities in particular). In addition, the number and ratio of limited liability companies (108), budgetary organs under central government control (41) and public share companies (28) are also high, which also holds true for foundations (21).

35 % of the 1 672 proposals were recommended for grants, which were also approved by the National Development Agency (Nemzeti Fejlesztési Ügynökség). Thus, grants totalling 268.047 million EUR (67.827 billion HUF) were awarded to the applicants (by 3Q of 2009), ca. 40 % of these grants reached the contracting stage at least. Irrespective of priorities, proposal activity and demand is suitably described by the figures giving the ratio of the grants requested and the amounts actually awarded. In these terms the demand for grants was 3.4 times greater than the amounts awarded.

The utilisation of the frames available for the objectives determined in the individual priorities in the Action Plan 2007-2008 in terms of the grants awarded is summarised in the following table.

Table 5.4 Amounts of proposal funds by priorities (million EUR)

Priority		Announced	Awarded	Contracted	Paid
1.	Creating a competitive local economy	53.957	33.771	11.032	4.406
2.	Strengthening the potential for tourism	56.716	56.204	38.813	5.603
3.	Settlement development	91.251	60.829	24.107	2.609
4.	Development of human community infrastructure	126.438	71.506	No data	No data
5.	Development of regional transport	53.686	45.737	32.733	7.421
Total		382.048	268.047	106.685	20.039

Source: NHOP AP 2007-2008 and EMIR database.

(downloaded in 3Q of 2009)

It can be stated on the basis of the status in 2009 that a considerable part of the funds announced, 70 %, was awarded to the applicants. In this respect the remaining part (29 %) is generated by the proposals that are still awaiting approval in the two-stage proposal system.

At the same time the share of funds contracted can be regarded as much more unfavourable, representing 28 % of the total amount announced. And the rate of grants paid (5.3 %) can be said to be extremely marginal.

In the Action Plan 2007-2008 the 'key projects' identified in connection with the priorities were as follows:

Priority 1: Mechatronics Industrial Park in Miskolc;

Priority 2: Tokaj Festival Valley, Lake Tisza Eco-Centre, Castle Island Cultural-Tourism Centre, Development of the L'Huillier-Coburg Mansion in Edelény;

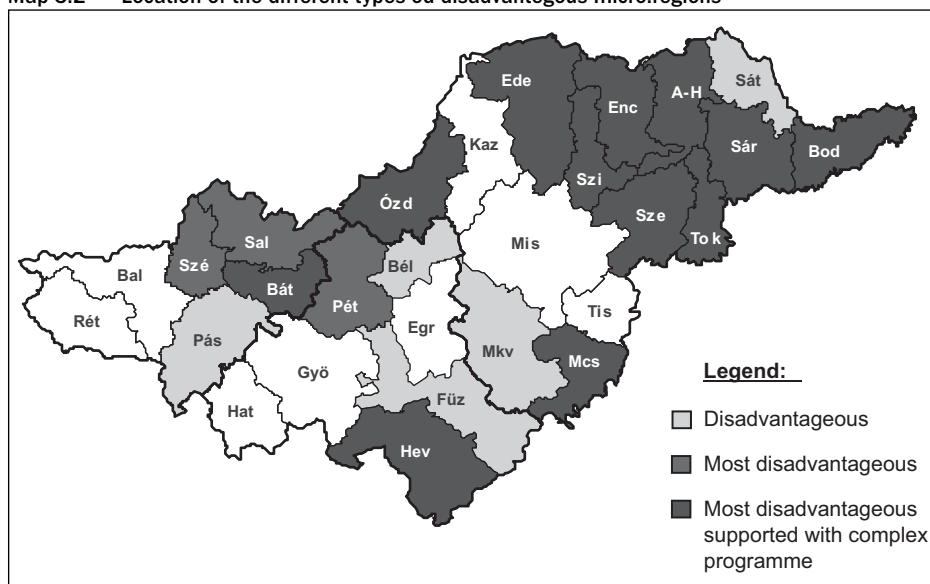
Priority 3: integrated rehabilitation of county centres (towns with the rights of counties).

The 'key projects' were invariably announced as a separate component (the awards for them are included in the priority). The grants requested for the six 'key projects' totalled 120.313 million EUR (30.254 billion HUF), for which grants amounting to 98.668 million EUR (24.811 billion HUF) have been awarded. The key role of the projects – as compared to the other components announced – can be seen both in terms of the amounts of the grants and in the payments schedule. In this case the proposal procedures were implemented relatively quickly and without delays. This is also supported by the figures, according to which the grants for 'key projects' amounted to 74 % of the requests for grants proposed in the contracting stage. The grant intensity of the 'key projects' is, on average, 88 %, which, with the addition of the own resources, amounts to an investment value of 98.668 million EUR, as mentioned above.

5.4 Dilemma of Efficiency Versus Cohesion – Review of Territorial Distribution of Proposals and Grants

The region of North Hungary has considerable disparities in terms of economic development. In addition, the range of micro-regions regarded as disadvantageous is wide and numerous even in national comparison. Accordingly, the key, topical question is to what extent the disadvantageous regions can make use of the possibilities offered by the EU funds. On the other hand, the examination of proposal activity and effectiveness from a geographical aspect is also important because the overall objective of NHOP gives priority to territorially balanced economic development and the reduction of territorial disparities.

According to Government Order 311/2007. (XI.17.) in force, there are only seven micro-regions among the 28 micro-regions of North Hungary that are not disadvantageous in some form (they are: Miskolc, Tiszaújváros, Eger, Gyöngyös, Hatvan, Balassagyarmat and Rétság).

Map 5.2 Location of the different types of disadvantaged micro-regions¹²

Source: authors' own compilation.

Due to the shortness of the available time horizon the territorial effect of the Action Plan 2007-2008 cannot be observed, and displayed yet. Thus just a comparative typology of the priorities and measures has been developed based on their likely territorial effects. The documentation of the AP 2007-2008 and the calls were reviewed and evaluated. The results have been summarized in the following table.

Table 5.5 Typology of priorities and measures by territorial effects

Priority // Measure	Likely territorial effect on disparities	Intensity of territorial effect	Is there specification for disadvantaged micro-regions?
1.	There is relevance for territorial cohesion in the priority.		
1.1.1	Differentiation	Intensive	No
1.1.2	Levelling	Moderate	Yes
1.2.1	Differentiation	Intensive	No
1.3.1	Differentiation	Intensive	No
2.	There is NO relevance for territorial cohesion in the priority.		
2.1.1	Differentiation	Moderate	No
2.2.1	Differentiation	Moderate	No
2.3.1	Differentiation	Moderate	No

¹² Legend: A-H: Abaúj-Hegyköz; Bod: Bodroghöz; Ede: Edelény; Enc: Encs; Kaz: Kazincbarcika; Mcs: Mezőcsát; Mkv: Mezőkövesd; Mis: Miskolc; Ózd: Ózd; Sár: Sárospatak; Sát: Sátoraljaújhely; Sze: Szerencs; Szi: Szikszó; Tis: Tiszaújváros; Tok: Tokaj; Bél: Bélapátfalva; Egr: Eger; Füz: Füzesabony; Gyö: Gyöngyös; Hat: Hatvan; Hev: Heves; Pét: Pétervárszék; Bal: Balassagyarmat; Bát: Bátonytereny; Pás: Pásztó; Rét: Rétság; Sal: Salgótarján; Szé: Szécsény

Priority // Measure	Likely territorial effect on disparities	Intensity of territorial effect	Is there specification for disadvantaged micro-regions?
3.	There is relevance for territorial cohesion in the priority.		
3.1.1	Differentiation	Intensive	Yes (indirectly)
3.1.2	Neutral	-	Yes (indirectly)
3.1.3	Levelling	Moderate	Yes (indirectly)
3.2.1	Levelling	Moderate	Yes (indirectly)
4.	There is NO relevance for territorial cohesion in the priority.		
4.1.1	Neutral	-	No
4.1.2	Neutral	-	No
4.2.1	Neutral	-	No
4.2.2	Neutral	-	No
4.3.1	Neutral	-	No
4.3.2	Neutral	-	No
5.	There is relevance for territorial cohesion in the priority.		
5.1	Levelling	Intensive	Yes (indirectly)
5.2	Levelling	Intensive	Yes (indirectly)

Source: authors' own compilation.

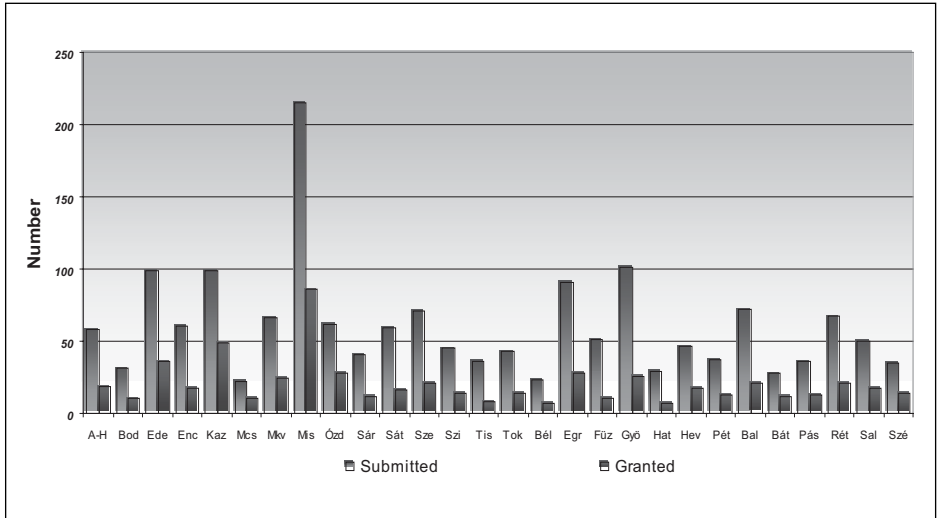
The priorities show high variety in their effects on territorial disparities. However the territorial cohesion as a horizontal principle appears – directly or indirectly – in almost all the priorities (except for Priority 4). The catch up of the disadvantaged micro-regions is also a frequently emphasized goal.

Priority 1 concentrates on developing economic growth poles (like industrial parks, clusters, and innovation centres), thus it is likely to weaken territorial cohesion (except Measure 1.1.2).

The outcomes of the numerical analysis of the micro-regional comparison are introduced below.

The activity of the micro-region of Miskolc was the highest on the basis of the territorial distribution of the proposals submitted. Close to 13 % (215) of the 1 672 proposals came from here. The micro-regions of Eger, Edelény, Kazincbarcika and Gyöngyös are the runners-up, though lag behind considerably, each submitting approximately 100 proposals. The other micro-regions show a nearly identical performance (40-60), among which the micro-regions of Mezőcsát, Béalápátfalva, Bátorfaterenye and Hatvan are the worst performers with the smallest number of proposals (under 30).

According to the number of proposals awarded grants, it is again the micro-region of Miskolc that is ranked first (86). As compared to the previous findings, the range of territorial units with a good performance shows only slight modifications, i.e. successful proposals arrived in larger numbers from the micro-regions of Kazincbarcika, as well as Edelény, Ózd and Eger (49-28). By contrast, the number of proposals integrated in the micro-regions of Hatvan, Béalápátfalva and Tiszaújváros was not even ten.

Graph 5.1 Distribution of proposals submitted and granted by micro-regions

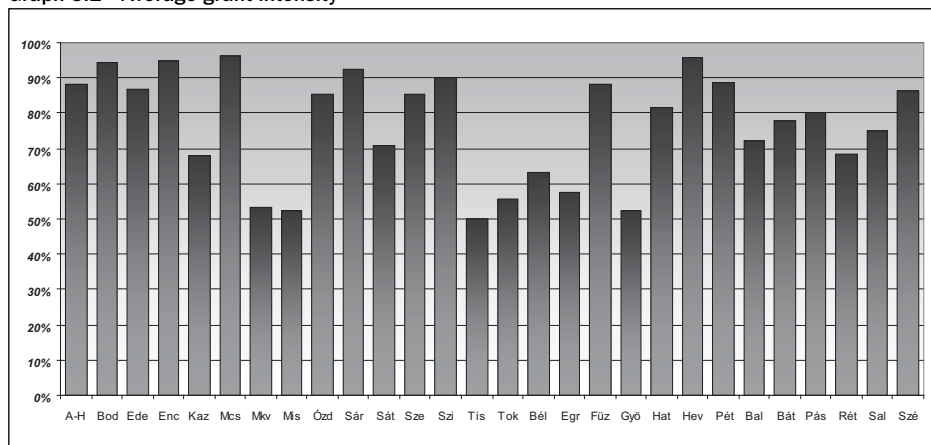
Source: authors' own compilation using EMIR database.

Proposals were submitted for 16 % of the grants applied (more than 143.2 million EUR (36 billion HUF)) from the micro-region of Miskolc. Demands for more than 39.7 million EUR (10 billion HUF) arrived from the micro-regions of Kazincbarcika, Szerencs, Eger and Gyöngyös. By contrast, the proposal activity of the micro-regions of Mezőcsát, Pásztó, Belpátfalva, Szikszó, Hatvan, Tiszaújváros and Abaúj-Hegyköz was much lower, not reaching 2 % each of the regional total (a total of 910.7 million EUR (29 billion HUF)).

The data show highly differing proposal activity and effectiveness in the micro-regions. This is also true when they show a similar or even greater differentiation and concentration in terms of population distribution.

Within the system of proposals, support for disadvantaged regions is most likely to be possible through higher grant intensity (grant/total costs). A considerable standard deviation can be shown among the individual regions in this aspect as well. Among the 28 micro-regions in North Hungary the ratio of grants exceeded 90 % in six (in the micro-regions of Szikszó, Sárospatak, Bodroghöz, Encs, Heves, and Mezőcsát). All of these regions belong to the category of the most disadvantaged regions to be supported by comprehensive programmes. This ratio is above 80 % in a further nine regions, the majority of which are also disadvantaged. At the same time the grant intensity did not exceed 60 % in five micro-regions, belonging to the central, more developed ones (the micro-regions of Gyöngyös, Miskolc, Mezőkövesd, Tokaj, and Eger), and it did not exceed 50 % in the micro-region of Tiszaújváros. Thus it can be stated that in terms of grant intensity, an adjustment mechanism worked in the period 2007-2008, which facilitated proposals with more favourable conditions for the less developed regions. This is of extraordinary importance because for the majority of applicants a higher value for their own resources may represent a reason for exclusion.

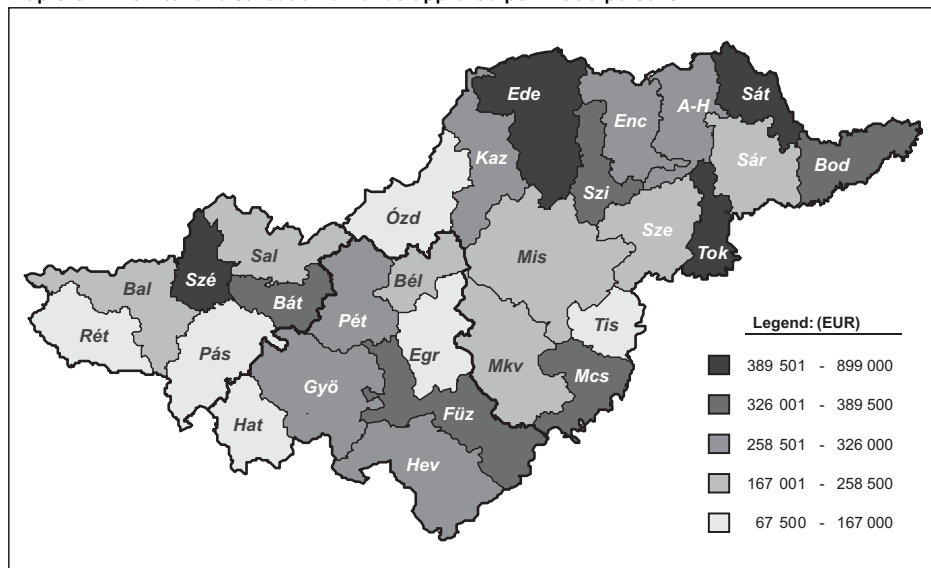
Graph 5.2 Average grant intensity



Source: authors' own compilation using EMIR database.

As seen earlier, micro-regions show considerable differences in terms of population, which worsens and decreases the utility of the results of the above comparison (the difference between the most populous micro-region of Miskolc and that of Bélapátfalva with the smallest population is more than twenty-fold). This heterogeneity justifies a specific comparison of the micro-regions using the values of the above data projected to 1 000 persons.

Map 5.3 Territorial distribution of funds approved per 1 000 persons



Source: authors' own compilation.

On the basis of the specific grants demanded (per 1 000 persons), the micro-region of Tokaj gave an outstanding performance (ca. 2.11 million EUR (531 million HUF)). The next category of micro-regions constitutes the micro-regions of Bodrogköz, Szécsény, Abaúj-Hegyköz, Füzesabony and Encs with a demand for app. 1.19 million EUR (300 million HUF). At the end of the ranking are the micro-regions of Hatvan, Pásztó and Ózd, which submitted proposals for the smallest amounts (lower than 100 million HUF).

The amount of grants approved on average amounted to one third of the amounts requested. On the basis of grants approved, the micro-region of Tokaj kept its outstanding lead position. The extent of grants did not reach or exceed a value of 0.398 million EUR (100 million HUF) in the micro-regions of Szikszó, Sátoraljaújhely, Edelény or Szécsény. The micro-regions of Hatvan, Rétság, Pásztó, Ózd and Tiszaújváros ranked worst in this aspect.

In terms of the comparison using specific values there is ambiguity as to whether disadvantaged regions have submitted proposals for smaller funds or whether they were approved smaller funds. What is more, in several cases, the highest values were produced by micro-regions in the most disadvantaged positions (e.g. the micro-region of Tokaj).

On the basis of the derived values it is ambiguous whether the allocation of funds in NHOP AP 2007-2008 primarily serves the objective of reducing disparities and strengthening cohesion or that of increasing competitiveness and thus an increase in territorial inequalities. The table below gives a summary of the values for the micro-regions that are disadvantaged position, the most disadvantaged and those in the most disadvantaged position to be supported by a comprehensive programme.

Table 5.6 Proposal activity of different types of disadvantageous micro-regions

Indicator	Disadvantaged ¹³		Most disadvantaged ¹⁴		Most disadvantaged to be supported by a comprehensive programme ¹⁵	
Number (persons) and ratio of population in total (%)	218 694	17.19	111 452	8.76	353 518	27.79
Number and ratio of proposals submitted in total (%)	275	16.43	122	7.29	666	39.78
Number and ratio of proposals supported in total (%)	105	18.23	45	7.81	229	39.76
Funds requested in projects (EUR) and ratio in total (%)	129 423 796.1	14.54	77 310 744.3	8.68	331 380 380.3	37.22
Total costs of proposals submitted (EUR) and ratio in total (%)	176 728 325.9	14.64	96 493 759.9	7.99	3 961 142 447.3	33.22
Grants for winning projects (EUR) and ratio in total (%)	46 845 925.6	14.93	31 130 695.6	9.92	115 818 311.6	36.91
Total costs of proposals supported (EUR) and ratio in total (%)	68 295 946.9	14.60	38 140 016.9	8.15	141 643 155.1	30.27

Source: authors' own compilation using EMIR database (downloaded in 3Q of 2009)..

The 21 disadvantaged micro-regions represented 63.5 % of the proposals, and in terms of winning proposals it is somewhat higher at 65.8 %. In the region of North

¹³ Disadvantaged micro-regions: Béalpátfalva, Füzesabony, Kazincbarcika, Mezőkövesd, Sátoraljaújhely, Pásztó.

¹⁴ Most disadvantaged micro-regions: Pétervására, Salgótarján, Szécsény.

¹⁵ Most disadvantaged micro-regions to be supported by comprehensive programmes: Abaúj-Hegyköz, Bátorfatereny, Bodrogköz, Edelény, Encs, Heves, Mezőcsát, Ózd, Sárospatak, Szerencs, Szikszó, Tokaj.

Hungary, 55.86 % of the total costs shown in the proposals submitted in the period 2007-2008 came from disadvantaged regions.

According to grants awarded, this ratio is slightly higher than 61.76 %. In every case these ratios exceed the disadvantaged micro-regions share of population (53.76 %). The positions of the three categories are, however, somewhat different. While disadvantaged micro-regions are slightly under-represented, micro-regions in the most disadvantaged position are somewhat over-supported. At the same time the most disadvantageous micro-regions to be supported by comprehensive programmes are supported to a higher extent than their weight in terms of population number.

The basic dilemma of economic development is likely to remain in the future. Actually the global crisis sharpens the question whether efficiency or cohesion enjoys priority. But, as with the Yin-Yang, the two priorities complement on another in North Hungary. Thus the NHOP is keen on finding the optimal combination and distribution of resources in both the geographical and sectoral sense.

On one hand the pulling force of economic centres (growth poles) has to be fostered, especially in times of crisis; on the other hand the parallel rising socio-economic disparities have to be treated during the transition process.

5.5 Evaluation of Economic Development During the Period of AP 2007-2008

The Priority 1 of NHOP serves the objective of creating a competitive local economy in the planning period 2007-2013. The priority supplements the Economic Development Operational Programme with a national range by means of region-specific measures.

The priority is aimed at improving the efficiency of operating a competitive local economy and its income generating capacity by means of supporting existing and new enterprises and technologies, introducing innovations, strengthening cooperation, and promoting the creation of jobs, first of all.

The four measures of Priority 1 are made up of a further 11 components.

Table 5.7 System of the measures and components of Priority 1 in AP 2007-2008

1.1.1. Development of regionally balanced industrial areas of regional and local importance		
	1.1.1/A	Development of regional industrial parks suitable for the settlement of businesses
	1.1.1/B	Preparation of industrial areas owned by the local governments
	1.1.1/C	Development and expansion of incubator houses
	1.1.1/D	Revitalisation of brown-field areas
	1.1.1/E	Key project
	1.1.1/F	Business infrastructure development in the most disadvantaged micro-region
1.1.2. Development of enterprises by consulting		
	1.1.2/A	Consulting for entrepreneurs
	1.1.2/B	Developing consultancy networks

1.2.1.	Development of cluster and corporate collaborations	
	1.2.1.	Establishing and strengthening cluster management organisations, joint purchase of instruments and investments
1.3.1.	Developing the innovation potential of the region	
	1.3.1/A	Establishing and strengthening cluster management organisations, joint purchase of instruments and investments
	1.3.1/B	Establishing and operating innovation transfer offices of regional importance and offering innovation services

Source: NHOP AP 2007-2008.

The measures denote the economic development points of weight of NHOP, and the components give their more detailed contents.

Measure 1 focuses on the preparation, development or revitalisation of areas suitable for industrial activities. Since the demarcation by a legal regulation in 1997, the number of industrial parks in the region has increased to 25 (14 in Borsod-Abaúj-Zemplén county, 7 in Heves county and 4 in Nógrád county). These industrial sites have played a decisive role in the economic development of the past two decades for they have contributed to the inflow and settlement of international investors and, as a result, of FDI. The measure's other important field of operation is managing the heritage of socialist industrialisation, 'brown fields'. Among the regions in Hungary, North Hungary is most affected by the problem of abandoned industrial areas. NHOP AP 2007-2008 identifies 76 brown fields in the region with a territory of 2 213 hectares. The management of these areas involves not only economic but environmental aspects as well.

The objective of Measure 2 is to improve the efficiency and domestic and foreign market activities of local businesses by means of management, accounting and marketing consultancy.

The objective of Measure 3 is to gather the players of the economy into clusters and promote an improvement in the market positions of its members. In terms of future economic development, it is essential that local enterprises are able to become partners and suppliers of the multi-national and trans-national companies (MNCs and TNCs) that have settled in the region or country. Several branches of the economy have seen economic players beginning to cluster (e.g. machine industry, health tourism, etc.). These fresh initiatives, however, still need considerable financial and managerial support. If it is possible to achieve sustainable and efficient operation in the case of clusters, then these groupings may even become the central element in crisis management strategies.

Last but not least, Measure 4 is intended to develop the weak innovation potentials of the region via propagating an innovative approach, and widening both the demand and supply sides of the narrow, weak innovation market.

Concerning Priority 1 AP 2007-2008 manages a framework of 53.957 million EUR (13.568 billion HUF). This amount became available in the period via four calls for proposals:

- *ĚMOP-2007-1.1.1* Supporting the development of industrial areas, industrial parks and incubator houses;
- *ĚMOP-2007-1.1.1* Development of regional industrial parks suitable for the settlement of enterprises;

- *ÉMOP-2008-1.1.1* Supporting industrial areas, industrial parks, incubator houses and the revitalisation of brown-field areas;
- *ÉMOP-2008-1.2.1* Supporting the joint investments of clusters of regional importance, establishing and developing their services.

A total of 81 proposals were received in answer to the four calls. In terms of form of operation, more than half the applicants (49) were companies with limited liability, in addition, government organs managed by local governments, public companies and joint-stock companies (5-9) were represented in larger numbers.

Concerning Priority 1, 3 key indicators were selected in order to measure the efficiency of the project: a 15 % increase in gross added value, an increase in the sales revenue of the companies and an increase in the level of development of the supported industrial areas.

- *Component 1.1.1/A* represents an increase in the infrastructure and service level of supported industrial parks, thus making them more attractive to working capital in order that the inflow of territorially concentrated working capital should assist in economic growth. Seven projects were approved under the call.
- *Component 1.1.1/C* aims at establishing and developing incubator houses, thus promoting an increase in entrepreneurial willingness and in the chances of survival for starting-up SMEs (Small and Medium sized Enterprises), so that the extremely low employment level of the region improves and the number of enterprises increases. Ten projects are enjoying support under the call.
- *Component 1.1.1/D* serves the purpose of revitalising brown-field areas, thus increasing the extent of areas which are potentially available for industrial activities and reducing the environment-loading impact of the industrial waste left behind. The support will facilitate the implementation of twelve projects.
- *Component 1.2.1* facilitates the establishment and development of clusters and corporate collaborations, thus increasing the strengthening of the enterprises' competitiveness and the utilisation of positive external impacts in closer collaboration in order that the amount of Gross Local Value Added (GLVA) should increase. The support will facilitate the implementation of nineteen projects.

The major financial parameters of the 48 projects supported by the two measures of Component 1 of NHOP AP 2007-2008 are as follows.

Table 5.8 Use of grant awarded and available funds, NHOP AP 2007-2008

Measure	Proposals received	Total funds requested (EUR)	Winning proposals (pieces)	Grants awarded in round 1 (EUR)	Grants awarded (EUR)	Funds available (EUR)	Funds used (%)
ÉMOP-1.1.1	44	47 296 475.5	29	1 731 289.3	29 922 877.3	36 455 847.3	82.03
ÉMOP-1.2.1	37	6 058 973.4	19	0.0	3 847 632.3	5 579 416.2	68.96
ÉMOP-1 total	81	53 355 448.9	48	1 731 289.3	33 770 509.6	42 035 263.5	80.03

Source: authors' own compilation using EMIR database (downloaded in 3Q of 2009).

The only 'key project' in Priority 1 is aimed at developing a Mechatronics Industrial Park in the centre of the region, Miskolc. The project wishes to promote the development

of industry, increase its job-creating capacity and increase the added value by relying on the town's centuries-long industrial history, its significant capacity, represented by the great number of heavy and machine industrial enterprises and its multi-disciplinary university with technical faculties.

In spite of the fact that in Priority 1 the amount planned was announced in total, as of September 2009 there is a considerable backlog in terms of funds both contracted and paid.

The success of Priority 1 is going to be evaluated by three main indicators:

- Contribution of the local enterprises to the Gross Value Added;
- Revenue of companies participating in clusters;
- Percent of used (occupied) area in the Industrial Parks.

In the case of the first indicators, the target is 15 % growth in the contribution of the local enterprises to the regional Gross Value Added by 2015. In the case of the revenue of companies collaborating in clusters, the goal is a 5 % increase by the third year of project support. As regards the development of Industrial Parks it is assumed that 75 % of the total area should be used by settled companies by 2015.

Further output indicators have been defined for each measure; nevertheless their realization cannot be fully verified due to two main reasons. On the one hand, there is insufficient, missing or an incomplete supply of data from the applicant and the monitoring system, which is not comprehensive or compatible, causes difficulties. Until now the Central Statistical Office (Központi Statisztikai Hivatal) has not provided data either. On the other hand, the global financial crisis basically changed the economic development prospects; and the new conditions require new target values.

Labour market data, given by the Public Employment Service (Állami Foglalkoztatási Szolgálat), can be applied in order to demonstrate the massive negative effect of the crisis. In North Hungary from 2007 to 2009 the number of unemployed people rose by 12 135 persons; in parallel with this, the number of employed people fell by 30 319 persons. At the end of the period the worst conditions were in Borsod – Abaúj – Zemplén County, with the highest unemployment rate (16.34 %); and the lowest employment rate (46.8 %) as well.

It is important to note, or rather repeat, that in the field of economic development the NHOP has only a complementary character; since the Economic Development Operational Programme (EDOP) is the main OP having more financial sources for accelerating the growth of the economy.

Among the four priorities, Priority 2 is dedicated to the comprehensive development of enterprises (focusing on SMEs). During the period 2007-2008 the following calls were announced especially for SMEs:

- Technology upgrade of the enterprises for SMEs (GOP-2.1.1/A);
- Creation and protection of work places combined with training and reduced working hours in the disadvantaged micro-regions (GOP-2.1.2/B);
- Comprehensive (technology) investments in the disadvantaged micro-regions (GOP-2.1.3).

5.6 Conclusions and Recommendations

Hungary receives 22.890 billion EUR of support between 2007 and 2013. The New Hungary Development Plan distributes these subsidies. The Plan contains 15 operational programmes of which each of the seven Hungarian regions could define and develop one. North Hungary is granted a subsidy of 1.063 billion EUR (with national co-financing) during the seven years.

The goal-system of the NHOP (overall and specific goals) is built on 5 priorities: creating a competitive local economy, strengthening the potential of tourism, settlement development; developing human community infrastructure; regional transport-development. Different weights are placed on the specific priorities and, accordingly, they share the budget in different proportions. Regional development is given the highest amount of subsidy (28.5 %), while regional transport-development gets the lowest (10.1 %).

The proportions are also influenced by whether or not a national-level Operational Programme is connected to the given development area, which can multiply the effects of grants.

We have undertaken a numerical analysis of the first Action Plan (2007-2008) of the NHOP in the course of this research, devoting special attention to economic development. We summarise our observations and experiences below:

A source of 382.048 million EUR (95.278 billion HUF) became available in the framework of the NHOP AP 2007-2008. Although this amount is by far less than the indicative financial fund of 1 021.390 million EUR (256.838 billion HUF) and it is even somewhat less than the plan (414.419 million EUR – 104.21 billion HUF), it means a significant fund sourcing that is 2.38 % in comparison to the GDP. The calls for tenders generated considerable activity: 1 672 proposals arrived. For each priority the subsidy demanded exceeded the available amounts many times over, which resulted in source-reallocation among priorities and in time.

Although 268.047 million EUR (67.403 billion HUF) were awarded to the beneficiaries (by the 3Q of 2009), just 106.685 million EUR (26.827 billion HUF) were contracted; and only 20.039 million EUR (5.039 billion HUF) were paid out. The primary reason for the slowness of the system is the oversized bureaucracy and the administrative burden; in many cases the lack of co-funding (resources) made the absorption of resources difficult.

An analysis of the spatial distribution of tender activity and success demonstrated the extraordinary discrepancies among micro-regions. On the one hand, the resource allocation of NHOP AP 2007-2008 meets the expectations of the socio-economic cohesion because the intensity of the support is higher in the underdeveloped regions. At the same time, it meets the demand of boosting competitiveness because more subsidies are granted to the more populous growth centres with greater economic weight (Miskolc, Eger, Gyöngyös, Salgótarján, Kazincbarcika, etc).

The economic development priority of the NHOP AP 2007-2008 is complementary to the Economic Development Operational Programme. It places emphasis on developing industrial areas and industrial parks, as well as incubator houses. Besides this, it treats the issues of brown fields with special attention. It promotes the growth in competitiveness of SMEs primarily via supporting the provision of consulting services and establish-

ing networks and clusters of co-operation. Finally, the objective enhances the innovation capabilities of businesses through networks and transfer offices. Support for industrial parks and incubator houses, treating brown fields, as well as developing the clusters enjoyed a priority in the AP 2007-2008. 48 out of the 81 tenders coming in to the four callings were supported, ca. 33.771 million EUR (8.492 billion HUF) altogether.

Following 2008, the indicators of the economic-social performance of Northern Hungary changed radically, worsening as a result of the global financial crisis. Naturally, the tender systems also have to adapt to the new conditions. It is necessary that those measures and subsidies that enhance the job-keeping capability of SMEs and boost their innovation capability enjoy priority. The resources should be made available simpler and faster for the businesses; and the allowances/preferences should be given to businesses because the other funding opportunities (e. g. bank-loans) have drastically decreased.

The measurement of socio-economic effects of the AP 2007-2008 concerning Northern Hungary is not feasible yet, due to the short time horizon and the missing statistical data. However, in the foreseeable future this part of the research may draw significant professional attention.

Finally, recommendations according to the experiences have been formulated, grouped under three headings:

a) Recommendations addressed to developing SMEs

- To reduce the interval from application to payment is of primary interest for all the stakeholders (decision-makers, entrepreneurs). So far the efforts made to simplify the evaluation procedure were not entirely successful.
- The administrative burden has to be reduced whilst keeping the legality and safety of the system.
- The main hindrances to SMEs taking the opportunity offered by EU funds are of a financial nature. Most of the SMES suffer from liquidity problems due to debts. The really high prime rate (11.5 % in 4Q of 2008 and 9.5 % in 3Q-4Q of 2009) has also hampered the financing of management and investments of SMEs.
- At the same time the lack of project-cycle-management is not a problem any more, as the entrepreneurs got acquainted with its logic, but constant training is necessary to keep possible applicants well-informed.
- In recent years the worsening labour market conditions represent the main challenges for economic development, therefore calls aiming to protect workplaces have to be announced (as already made in EDOP).
- With the allocation of the EU funds the innovative investments (regarding new technologies, know-how, etc.) should be financed more intensively (like the function of seed capitals) in order the help the SMEs become more efficient.

b) Recommendations addressed to the planning system

- The relationship should be stronger among the organisations of the institutional system in the case of the NHOP and the sectoral operational programmes (especially the Economic Development Operational Programme) which is explained by the general economic situation and the socio-economic situation of the region.
- The global financial crisis of the 4Q of 2008 had an extremely negative effect on Hungary; it radically changed the growth path of the economy, the economic

actors' operating condition and the quality of life of society. It means re-thinking the situation analysis of the NHOP and the target values in order to eliminate unrealistic expectations.

c) Recommendations addressed to the administrative system

- The indicators for monitoring should be made public, and transparent in a catalogue when preparing the call for tenders.
- Multiplicative impact analysis, relating to the project, has to be developed. In this way the tender writers can introduce the expected impacts on the basis of a uniform view and methodology.
- The operation of the tender evaluation and administrative system should be made simpler and more efficient so that the subsidies can be paid out faster.

d) Recommendations addressed to the evaluation system

- The preparation of a uniform structure and methodology for the evaluation reports concerning the action plans is necessary. This could make inter-regional comparisons possible; it could make the reports simpler and more transparent and the potential faults and deviations from the goals could be followed better.
- In the future it will be necessary to have the preparation of a national programme-evaluation system that can handle the differences stemming from the different priority-system of the regional operational programmes simultaneously, and, at the same time, that can make the efficiency of the particular OPs measurable and comparable via ex-ante and ex-post analyses supported with the same methodology.
- The core of the system is the database that makes a record of all the projects submitted during the planning period. The database should store all the information necessary for the analysis (e. g.: cost-benefit analysis (CBA)) A professionally established and maintained database makes it possible to have various statistical analyses measuring efficiency and map-representation of data with a so-called geo-reference.
- It is vitally important that the database follows the whole life-path of the (winning) project from tender preparation to the project's end and, possibly, in the follow-up period as well. The evaluation period is of paramount importance from the point of view of evaluation, especially in the case of the multi-round tenders.
- The dataset of the current information system is not appropriate in making regional-level comparisons. The static and undefined database should be redeveloped. It should be converted into an online system based on a single and well-defined database.

6

EVALUATIONS IN
VISEGRAD COUNTRIES

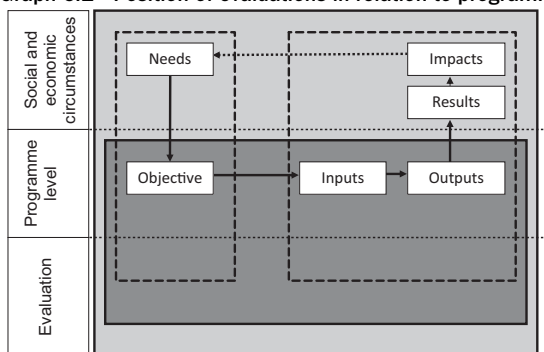
Evaluation serves as a management tool to judge the effects and impact of policies, programmes, projects or any other interventions and to improve the policies. It is well established in countries with long democratic traditions. As in other pre-accession countries, in the Visegrad countries too, evaluation was a practically unknown term, until 1996. Not only were evaluations unknown, but there were also missing capacities on both the demand and supply sides. Nevertheless, an evaluation culture has gradually developed. Right from the beginning, for many people, it has been difficult to distinguish between evaluations, audits and monitoring.

Even six years of EU membership has not changed some problems with evaluating public expenditure programmes in the countries in question, although the Structural Funds assistance requires evaluations to be applied at all stages of implementation. As Batterbury (2006) mentions, the use of evaluations is generally limited and some purposes of evaluations are not used much. It is not only the public administration in the new Member States, but the managing authorities throughout the EU sometimes have problems with using the results of evaluations.

An assessment of the evaluation methodology used in Slovakia and the Czech Republic during the 2004-2006 programming period was motivated by a need to verify that the evaluation of programmes financed from the ESF was conducted in order to provide stakeholders with information about the programmes' impacts and effectiveness. Evaluation is not the end in itself; it has to be a means to obtain certain information. For example it acknowledges that the funds were spent effectively, i.e. that value for money was delivered.

The results of evaluations are influenced by circumstances around the programmes and for example the effect of global economic development should be taken into consideration. The following graph shows the complex view of the role of the programmes' evaluation in connection to social and economic circumstances.

Graph 6.1 Position of evaluations in relation to programmes and wider circumstances



Source: EVALSED, EC 2008; *The New Programming Period, 2007-2013: Methodological Working Paper, Working Document No. 2, Indicators for monitoring and evaluation: A practical guide*, EC 2006, changes made by authors

This chapter examines the development in the use of evaluations, evaluation culture and evaluation methods in two Member States – Slovakia and the Czech Republic. We will also mention Hungary and Poland as there are some common aspects typical for all Central European countries in transition during the 90's. The main focus of the chapter is on the first two countries.

6.1 Evaluation and the EU Pre-accession Period

As has been already mentioned, evaluation was quite a new tool in the new Member States until 1996. Then the European Commission (EC) introduced a monitoring and assessment service for projects and programmes funded within the pre-accession assistance PHARE in all EU candidate countries. As this instrument was rather new for the EC as well, specific features and standards of the operational monitoring and evaluation systems had to be gradually shaped in the period 1996-2001. The applied unified methodology largely followed the evaluation reporting criteria introduced by the OECD Development Assistance Committee (DAC) for evaluating development assistance. The first procedures, guidelines, manuals and forms for the monitoring and evaluation reports were prepared and the groundwork for the decentralisation of PHARE monitoring was laid down.

Formal arrangements were established by the EC and National Aid Co-ordinators in 2000. Joint Monitoring Committees (JMCs) supported by Sector Monitoring Sub-Committees (SMSCs) were established in each candidate country to manage the monitoring of the implementation of all pre-accession interventions. The monitoring responsibilities were fully decentralised and taken over by the national authorities. The gradual decentralisation of management responsibilities was part of the transformation process preparing these countries for managing the Structural and Cohesion Funds.

Since 2001, the Evaluation Unit of DG Enlargement designed and introduced an Interim Evaluation system. Staff of the National Aid Coordination Unit within the Office of Government in Slovakia, responsible for the management of the monitoring process, was also prepared to manage the future evaluation system. Interim Evaluation management was closely linked to the responsibilities of the JMC, which was responsible for reviewing the progress of all EU funded interventions implemented in the country and for assessing the progress made towards the objectives set out in the programming documents.

The JMC meetings also introduced a feed-back mechanism reporting the progress regarding the measures recommended in the evaluation reports. The evaluation was not perceived of as merely a formal procedure, the concerned institutions were fully accountable for the measures adopted and had to report on progress in achieving them at least twice a year.

Although the system of monitoring and evaluation was well established and fully operational, it was closed down with the completion of the EU pre-accession interventions in Slovakia. The main coordination and management role (including monitoring and evaluation functions) was taken over by the Community Support Framework Department at the Slovak Ministry of Construction and Regional Development. Following EU accession, new structures were established in parallel with the existing pre-accession structures in

Slovakia. There was a complete lack of communication and/or transfer or exchange of experience between these simultaneously operating bodies.

Apart from the evaluation of EU pre-accession assistance, some evaluation activities for bilateral assistance were carried out in Slovakia, although to a less significant extent and size. Donors like the Canadian CIDA, American USAID, Dutch MATRA and many others most likely required an evaluation of their development aid, but very little is known about these evaluations. The same might apply for the evaluation of grants received by many non-governmental organizations, which could have been organized by the donors' organisations.

6.2 Development of Evaluations after EU Accession

6.2.1 Development in the Use of Evaluations

EU membership brought the concept of programming to the Visegrad countries and the EU brought the Structural Funds to the new Member States. An important part of the programming is the evaluation of the operational programmes (OPs). The first experience with evaluations of OPs was the ex-ante evaluation of OPs. Not only was evaluation a new approach for many public servants, the ex-ante evaluation was even less understandable for them as the programme had not even started. The preparation of complex programmes was a new issue to the public administration. For example only few of the Czech public expenditure programmes had clearly defined objectives. Low experience with preparing the Structural Funds operational programmes was proved in the ex-ante evaluation (for example see box 6.1). On the other side, the European Commission was aware of this and some activities were not required in the case of the new Member States. One example was econometric modelling of the future impacts of the Structural Funds assistance in the first programming period 2004-2006.

Box 6.1 The ex-ante evaluation of the Single Programming Document for Objective 3 (SPD 3) in Prague.

The analysis of the socio-economic situation, as presented in the SPD 3 for Prague programme document, has not been too sophisticated in all its parts (MoLSA and Prague, 2003). There was no econometric analysis proving that tertiary education, or particular study branches, had any effect on productivity or economic output. Needs "to develop and diversify the range of study opportunities at the universities" and to expand tertiary sector capacity, especially the capacities of publicly financed universities, were declared (MoLSA and Prague, 2003). It should have been explained in detail which study branches in particular had been insufficient and should be supported. Moreover, it should have been specified what study opportunities should be developed in order to contribute to economic development. Another case is the Community initiative EQUAL in the Czech Republic and in Slovakia. The part concerning monitoring indicators in CIP EQUAL in the Czech Republic was completely missing. It led to every beneficiary developing its monitoring indicators including defining them. It wasn't possible to aggregate such indicators at the programme level as the definitions differed. This caused problems in the use of the monitoring indicators in the first phase of project monitoring, let alone the evaluation. Later, the monitoring indicators were unified at both the programme and project levels with compliance to the EC requirements.

A great deal of attention was devoted to the objectives of the programme because the success of the ex-post evaluation process as well as the programme itself, at least formally, depends on how well the system of objectives, and indicators, is set. The evaluation team examined the objectives as to whether they fulfil basic requirements. It found out that the objectives had factual merit but it objected to formal drawbacks, especially the absence of operational objectives at the level of measures and inappropriate formulation or use of terminology (Národní observatoř zaměstnanosti a vzdělávání, 2003).

For example criticism was focused on the objectives hierarchy. Hierarchically lower objectives were not always more specific or narrower than hierarchically higher objectives. The formulation of objectives at the level of measures was too general and it did not always express the final situation expected after implementing individual measures or projects. Even the formulation of some objectives suggested that related activities would aim at issues which were not consistent with the ESF policy (Ex-ante evaluation of SPD 3). The reservations of the evaluation team about the objectives' formulation may indicate that to design correct and verifiable objectives was no trivial task within the creation of the programme documents and that there was much that the programme managers could have learnt. However, it may reveal, on the other hand, that the objectives' formulation process is subject to politics where the general, vague formulations reflect the heterogeneity of interests of the various institutions involved in the programme design. Moreover, the more specific the objective the higher risk that the ex-post evaluation could come to the conclusion that the objective was not achieved.

Not only has one-year financial planning changed to seven-years planning in regional development policy, but also a massive use of evaluation was brought to the countries in question in comparison to previous practice. The spending of money in the public expenditure programmes became less important criteria in comparison to the effects of the programmes and long-term impacts. Evaluation was seen as a control instrument at the beginning of the programming period in 2004 in the Central European countries. Then, it was perceived of as an EU legal requirement at the end of the programming period and the beginning of the new one. Now, in Poland it is used as an instrument for the management and accountability of the programmes (MRD Poland, 2009, p. 149). This perception was introduced by some institutions in the Czech Republic, e.g. Managing Authority of OP HRE.

As mentioned above, the new structures, ensuring design and implementation of the interventions funded from the Structural and Cohesion Funds, have been established in parallel with the then existing EU pre-accession structures at various ministries and other public administration institutions in Slovakia. Thanks to that, the human resources with sufficient skills and experience, which could enable a smooth start up of the structural policies, remained largely unused. Moreover, the traditional high turn-over of the civil servants and numerous organisational changes, which were taking place continually, resulted in minimal benefits despite the 12-years effort trying to establish teams of specialists understanding project management, implementation, monitoring and evaluation. These deficiencies had a significantly adverse impact on the capability of the newly established state administration bodies to manage Structural Funds, despite substantial staff increases.

The negative influence can be largely attributed to external factors, namely the incomplete public administration reform and the prevailing political environment. The Civil Service Act underwent nearly 20 amendments within two years of its approval and did not manage to separate political and administrative functions. Changes in administration thus followed the frequent political changes; e.g. from 2004 until 2008 ten people held the position of the Director General of the European Social Fund Section (ESF) at the Ministry of Labour, Social Affairs and Family (MoLSAF). The effort to introduce reforms in various sectors was disturbed and the political will to introduce evaluations was weak. The experience so far indicates that Slovakia lacks both supporters and the political will to professionally implement evaluations.

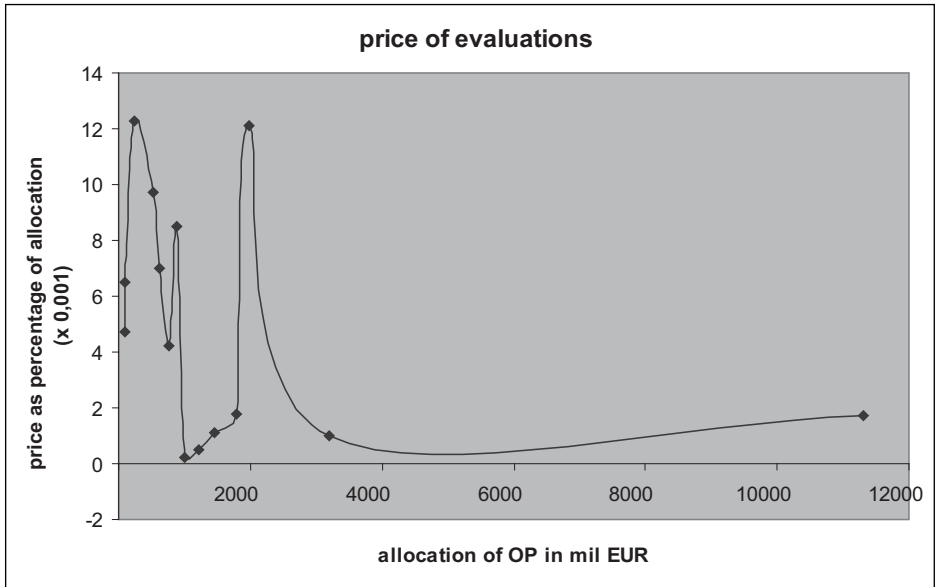
In general, the evaluations have been and are still rare. Until now, the Slovak Republic has not launched any evaluation of a project, programme, policy or any other intervention funded solely from the state budget. The obligatory evaluations are practically the only assessments that are taking place. This is valid namely for the ex-ante evaluations of the Operational Programmes, which would not be otherwise approved by the EC. The evalua-

tions are taking place only because of external EU pressure and are generally perceived as an imposed administrative obligation. The use of evaluations is thus very limited, therefore they neither make any significant impact on accountability nor are any lessons learned nor is feedback received by the policy-makers. With the exception of ex-ante evaluations, no mechanism has been established to ensure that the recommended measures are taken on board and implemented. Moreover, the qualification, knowledge, experience and skills regarding the administrative monitoring and evaluation functions are very limited and some problems can also be attributed to the insufficient administrative capacities.

The identified weaknesses are reflected in the design and management of the evaluations. The selection of bids in the tenders is assessed only according to the price criterion, although the guidelines recommend that the financial criterion should not exceed 20 – 25 % for assignments that are not entirely routine (Tavistock Institute, 2003). Moreover, the estimated price range is extremely wide as confirmed in the following example.

Ex-ante evaluation of an OP is a relatively standardised process. Based on that, it can be expected that the price of such an evaluation will depend on the size of the OP (financial allocation), and will roughly represent the same percentage of the overall sum allocated. According to the general guidelines, large scale routine programmes require a budget, which is a small proportion of the programme resources (normally less than 1 %) (Tavistock Institute, 2003). When comparing the prices of the Slovak OPs for the programming period 2007-2013, these were in the range of 0,23 – 0,0002 %, i.e. the price difference between the cheapest and the most expensive evaluation was 1000 times (the following graph does not include the top border value).

Graph 6.2 Price of evaluations in Slovakia



Source: Information of Slovak Ministries, Own calculations

6.2.2 The Evaluation Culture

The studies conducted after the EU accession confirmed that evaluation culture in the new EU Member States is not sufficiently developed. The analysis carried out by the Evaluation Advisory Group in 2004 states that the typical evaluation unit used to be small and under-resourced. There were practically no evaluations outside EC requirements and they were not used for accountability (EMS Consortium, 2004).

The benchmarking of evaluation capacities in the new Member States against baselines in the countries themselves and against experience in EU-15 Member States was carried out by the Centre for Strategies and Evaluation Services from 2004-2006 (Malan, 2005 and 2006). It concluded that evaluation activities are steadily improving and gradually having much more influence on programmes/policies in the new Member States. This was found as a significant contribution to developing evaluation culture in these countries, namely in terms of a much more improved availability of evaluators with the right skills.

The evaluation culture in the Central and Eastern European countries is not well-developed, according to Malan (2005), in comparison with Northern Europe, where such a culture is well-developed (Bachtler and Wren, 2006). The situation is slowly getting better, despite the increase of evaluations of Structural Funds (Blažek and Vozáb, 2006). Sometimes neither EU methodologies (European Commission, 2008) nor other methodologies are able to give answers to more complicated methodological questions (Potluka and Květoň, 2009)

However, the role of public authorities was not perceived very positively and no procedures were identified to ensure that evaluation results contribute to policy formulation. Despite this positive development, compared with the evaluation capacity in the EU-15 Member States, they still lag behind considerably. The survey conducted within the Malan's (2006) study showed that nearly 50 % of respondents in the new Member States found the evaluation activities as insufficient, while in the old Member States it was only 27 % of respondents (Malan, 2006). Nevertheless, it should also be noted that in quantitative terms (e.g. comparing with the same size country) Denmark makes some 2 000 evaluations annually, while in Slovakia it is around 10 on average and this should also be reflected when judging the sufficiency. Similar conclusions regarding the evaluation culture and available capacities were confirmed by the study for the EC on Developing Evaluation Capacity (EStep, 2007).

The main procedural causes of the poor situation in the new Member States were poor definition of objectives and indicators and low quality of monitoring indicators and systems. When adding poor methodology in evaluations of long-term socio-economic impacts and poor application of recommendations into policy-making, then it is clear that there was a lack of know-how and skills on both sides – public administration and evaluators (Malan, 2005).

The situation in the development of evaluation culture repeated again in the case of accession in 2006. The assessment of Romanian evaluation culture, at the time of its accession in 2006 re-confirmed that there is a lack of qualified professionals. Guidelines and methodologies are not available, and the public administration does not support evaluation capacities – thus evaluation culture is largely missing. The fact that

evaluation results were not being fed into policy formulation was identified as the most important problem. Additionally, there were also significant deficiencies in the indicators set up. Nevertheless, the conclusions found that commercial motivation was the basic precondition for change (Curley and Perianu, 2006).

6.2.3 Evaluation Methods

Efficiency of public expenditure programmes is one of the core discussions in the field of economics. It is mainly given by the evaluation culture and poor evaluation methodology of such interventions. Moreover, evaluations are usually financed by those who are being evaluated.

Bachtler and Wren (2006), Mairate (2006) or Batterbury (2006) point out the basic dilemma of evaluations – whether evaluations are done just to justify public expenditure programmes or they are done for long-term objectives (e. g. improving the programmes evaluated and increasing their impacts and efficiency). Batterbury (2006) extends the issue of evaluations not only to incorporate the process of improving the programmes, but also the relationship of target groups and programmes.

There are many studies dedicated to the impacts of the Structural Funds. Among others, many evaluation projects have been done by consultancy companies. Those studies did not solve methodological questions and were in many cases solely aimed at procedural steps without evaluating impacts as this question is much more complicated. The situation is much better in the field of scientific research and it is possible to follow the results, although, in this case too, many published articles are more oriented on procedure than impact.

There are some methodological problems with the definition of impacts and distinguishing them from impacts due to wider circumstances. A useful approach for evaluating an impact is a counterfactual evaluation or comparative analysis. An example of such a comparison is the case of Afonso and Fernandes (2006) study. They tested such an approach in a sample of public expenditure programmes of municipalities in Portugal.

The evaluation methods used and the quality of the methods applied have been developing as evaluation culture has been developing too. Not only did public administration have to learn which evaluations to do and why. The evaluators had to learn how to do evaluations and which methods are most appropriate.

6.2.4 Using Evaluation Methodology – the Case of the SPD 3 in Prague

The following part is dedicated to the mid-term and ex-post evaluation of the SPD 3 in Prague. The following situation demonstrates the situation in the evaluation processes in the Czech Republic as a whole and can be applied to other evaluations (included those done by the authors of this chapter).

The mid-term evaluation of SPD 3 in Prague was of a formative type which was intended to help programme actors improve their decisions and activities (Elbona and Akseš, 2005). This on-going evaluation chiefly focused on relevance of the programme strategy,

priorities and measures as proposed in the programme documents as well as on implementation procedures. An important task of this evaluation was to obtain information from various stakeholders on their practical experience from the activities they carried out within the programme's implementation, as well as their opinions on the success and efficiency of the current programme implementation. This is apparently the reason why methods of information collection played a key role in the mid-term evaluation. The evaluation team employed the following techniques: focus groups, individual stakeholder interviews and a questionnaire survey.

Apart from the information obtained by the tools mentioned above, the evaluation team analysed documents related to the SPD 3. These were strategic documents at both the EU and national levels, changes in Czech law which could have had an impact on the programme's implementation, various studies and analyses concerning financial support from the Structural Funds etc.

It is apparent that qualitative methods prevailed in processing information. Outputs of the on-going evaluation were thematic reports for particular issues which describe the state of the arts, identify weaknesses, answer evaluation questions, provide recommendations on how to eliminate barriers, and how to solve problems indicated by both stakeholders and the evaluator. A major part of the information for the evaluation was provided by beneficiaries. This is a general issue of almost all the evaluations made during the 2004-2006 programming period. The problem of such an evaluation is that it depends too much on the beneficiaries' subjective opinions. If the beneficiaries had problems with financing their projects, their responses gave a bad account of the implementation agencies and the programme as a whole and gave a good account of themselves.

Analysis of secondary qualitative information (e. g. various documents, strategies, measures, description of tasks etc.) was used to assess the relevance of SPD 3. Based on a comparison of SPD 3 goals with the goals of employment policies of both EU and national authorities, the evaluation team concluded that SPD 3 is relevant and aims to achieve global as well as specific programme objectives. Although the evaluation team identified barriers to successful realization of the programme it came to the conclusion that the current political and economic development in the Czech Republic did not need to enforce any changes in the programme. Nevertheless, it might be useful if the evaluation team showed its capability to foresee less convenient future developments or if it outlined several scenarios using future studies methodology instead of its confirmation and prolongation of the status quo described in the programme documents.

As in the case of the ex-ante evaluation, the mid-term evaluation had no appraisal of the economic suitability of the proposed measures. However, it can be supposed that the documents the evaluation team analysed had been based on previous analyses.

The evaluation team combined a qualitative analysis of texts with a focus groups technique in order to assess the quality of the monitoring and indicators. Participants of the first focus group verified that the information came from the documents about the information system. Moreover, strengths and weaknesses were identified and recommendations on how to solve problems were formulated. A similar approach was chosen in order to evaluate the programme's administration and implementation. The second focus group discussed the project's selection procedure in detail. The result of this structured discussion was a SWOT analysis identifying barriers inhibiting project quality.

In addition individual stakeholder interviews helped to further specify the findings from the focus groups or other comments. Setting of indicators was also the topic of structured interviews in order to find out whether the proposed monitoring system and system of indicators were effective and efficient and what problems the stakeholders faced.

The questionnaire survey was employed to obtain information from project managers across programme measures, for example on difficulties with submitting project proposals, the availability of information and support to prepare a good project proposal. Another aim of the survey was to estimate whether the promised objectives will be fulfilled as well as to estimate the impact of SPD 3 on human resources development in Prague.

An important part of the evaluation was an assessment of the quality of projects submitted to the programme scheme, especially of approved and contracted projects. In this case the evaluation team did not rely solely on qualitative data, both secondary and primary as stated above, they also used quantitative data drawn from the information system MSSF MONIT. By the way, the evaluation team often complained about this information system, e. g. that it did not contain the necessary data. It remains a problem in the programming period 2007-2013.

Firstly, the evaluation team focused on how much contracted projects had amounted as a share of the total revenues allocated to particular measures in order to indicate which measures were attractive, and where, on the contrary, it would be necessary to encourage subjects to submit projects. The poor quality of submitted projects, with respect to the formal requirements, was considered as one of the reasons for inadequate allocation in certain measures. Consequently, the evaluation team suggested to intervene in order to enhance the formal quality of project proposals or even to carry out some kind of marketing aimed at eligible applicants in order to increase their interest in taking part in the programme. However the evaluation team did not inquire into the factual intentions, activities and expected effects of the project proposals, rejected or approved. It seems that the evaluation team placed a greater emphasis on the formal requirements that a project proposal must fulfil rather than on how a project can in fact contribute to the effectiveness of the measure, priority or programme as a whole.

The evaluation team declared that there was a negative proportion between the formal and factual aspects of the project applications: the better the application in terms of formalities the vaguer the content of the project. For example it was stated that the applications did not describe the quality of service, had no clear description of a quantification of outputs and results, projects did not include an analysis of the target group of clients and that budgets were overestimated and with no specification of the relationships to activities covered by the budgets.

Regarding the effectiveness of the projects that were approved and contracted, the evaluation team tried to determine to what extent individual projects contribute to attaining the specific objectives of the measures. A match between the benefits declared in a project and the specific objectives that a project should achieve was made for 150 projects. This exercise showed which objectives were covered by projects less or more, but it did not provide any evidence that the objectives would be really achieved. Instead the evaluation team concentrated rather on formal aspects, which are available for ex-

amination more readily than data on factual activities. In addition the second focus group indicated the real motivations of applicants to obtain a grant from the ESF. The motivations were e. g. to enhance the finances of existing services or to cover other needs. Moreover, 80 % of projects managers participating in the questionnaire survey responded that projects helped to develop the activities of the organizations and are already running (Elbona and Akses, 2005).

Furthermore, the evaluation team examined what chance there was to fulfil the target values for indicators of outputs, results and impacts (effects) set out in the programme documents. The method used was a simple comparison with the values of the indicators of outputs or results planned in the contracted projects and to put them in the MSSF MONIT information system. The evaluation team had to conclude that even before the projects were finished, the indicators of a number of measures were exceeded. An exception was the indicator of jobs supported which was not fulfilled at 100 % (Elbona and Akses, 2005). The excessive values planned by the applicants may prove that the target values were underestimated, as well as that the values, expected to be achieved after the projects were finished, were overestimated. Responses from the structured interviews also suggested that the planned values of the indicators were not always correctly estimated. Finally, the evaluation team doubted the reliability of the data put into the MSSF MONIT information system.

The final evaluation employed similar methods of primary data collection as the mid-term evaluation, i.e. semi-structured interviews, a questionnaire survey among project managers, final beneficiaries and final recipients, and stakeholder consultations. In addition the evaluation team used secondary data provided by the MSSF MONIT information systems (i.e. data about projects and grant schemes, information about target groups, activities, territory of impact, expenditures etc.). Secondary data sources also included reports and studies of the area under consideration and documents related to the lifetime and management of the programme.

Since the final evaluation had been conducted before most projects were finished there was a lack of necessary data in the MSSF MONIT information system (REDECO, EUSERVICE.CZ and GLE, 2008). Therefore, it was difficult to analyse quantitative data and to assess the programme's actual outputs and results. Moreover, project managers were so busy with finishing off the projects when the evaluation team was gathering information that they could not provide the evaluators with sufficient information and on time (REDECO, EUSERVICE.CZ and GLE, 2008).

Box 6.2 Results of the final evaluation of SPD 3

The effect of the SPD 3 projects on employment was examined on the basis of comparing the number of jobs supported as a consequence of the SPD 3 projects completed by the date of the evaluation, as provided by the MSSF MONIT information system, and the number of job-seekers as measured by the Czech Statistical Office. The evaluation team stated that the effect was "marginal". It acknowledged that there were other factors beyond the SPD 3, such as the phase of the economic cycle, the labour and social security law as well as people's attitudes, , namely the young, to work, which had a greater impact on employment (REDECO, EUSERVICE.CZ and GLE, 2008). Moreover, the comparison of the numbers of jobs and job-seekers was not complemented by any analysis of benefits induced by the support for jobs or by any qualitative features of the jobs supported. Nevertheless, the evaluation team expected significant future effects of the SPD 3 projects, e.g. a better attitude to lifelong learning, increased knowledge about inequalities on the labour market and suggestions on how to deal with them and new skills in management of human resources projects. The evaluation team considered these effects to be the main benefits of SPD 3 (REDECO, EUSERVICE.CZ and GLE, 2008). However, it can be supposed that such effects will be difficult to measure and verify. It is a future challenge for the evaluation methodology used in the Czech Republic.

A combination of quantitative and qualitative analyses was used to evaluate the efficiency of the implementation of individual priorities of SPD 3. Available data from the MSSF MONIT information system, supplemented with information gained through the questionnaire survey, served to construct indicators describing the distribution of the contracted projects according to various characteristics, e.g. a sector of the economy, the amount of the grant, the target beneficiaries or the type of activity. This simple analysis revealed how the ESF was allocated, organizations in which sectors were involved, which activities were supported, which groups benefited from the public expenditure or how the funds were distributed across the measures and objectives.

Furthermore, the values of outputs and results indicators from the MSSF MONIT information system on 31 October 2008 were compared with the target values of indicators at both the priorities and programme level. A significantly large excess of the indicators for persons assisted and institutions supported and the poor performance of the supported jobs indicator may signal drawbacks in the indicators system or a failure in the projects realization.

To sum up, the mid-term as well as the final evaluations tried to indicate whether and to what extent the programme objectives were achieved. It also assessed whether there were chances that objectives would be achieved or that particular measures would meet the given target values of the indicators. The evaluators came to the conclusion that there was a great chance the programme objectives would be fulfilled.

However, such a conclusion has been inferred mostly from the analyses of information and data drawn from various texts or provided by stakeholders involved in the programme implementation. The conclusion has not been inferred from any empirical analysis of causality between SPD 3 and socio-economic development or employment respectively. The achievement of the objectives was only assessed at the formal level, on the basis of a comparison of the quantified targets of numbers of persons assisted, institutions supported or jobs with the actual numbers. A possible impact was indicated by the evaluation team in spite of the absence of any analysis of the impact. Furthermore, neither the mid-term nor the final evaluation could ensure that resources were used efficiently. The reports only present the allocation of funds to particular priorities and measures but no results of analyses of the efficiency or effectiveness, e. g. cost-benefit analysis. The evaluations did not assess whether limited resources were used to the best advantage.

In spite of the objections, the evaluations still make a contribution. The main benefits of the mid-term and final evaluations are primarily information and experience from programme implementation. This experience and information is very valuable for improving programme management. The mid-term evaluation was conducted on the EC's recommendation in order to use its findings to develop internal evaluation capacity – it has been achieved. The mid-term evaluation was of the formative type and so it couldn't provide complex feedback to various groups of stakeholder. The final evaluation was pretty critical. It identified a number of critical issues at different levels of the programme's implementation and recommended solutions. It tried to explain what worked well and what, on the other hand, did not. Not everything succeeded, was managed well and not all the subjects involved worked well. The output of the final evaluation can be used for developing, strengthening or building capacities as well as for stakeholder learning. It can provide a good lesson for the next programme.

As Sarah Batterbury (2006) says, a significant motivation for evaluation is “the desire to have a positive influence on policy”. I think the evaluation reports, which were assessed,

can contribute to learning how to better design, implement and deliver other programmes. Evaluators produced what they could within the given resources and institutional settings. They seem to have balanced the available methods with the demand of pragmatism.

6.3 NGOs' Access and Participation in the EU Structural Funds

Although being neglected, the NGO sector is a quite a strong economic and social force in the country and its power should not be underestimated. For example, in Slovakia it employs three times more people than Volkswagen, which is one of the biggest employers in the country and creates about 1.7 % GDP. Overall the NGO sector covers a very wide scope of various bodies serving different purposes (associations, foundations, religious institutions, schools, hospitals, etc.). Officially, the number of registered NGOs in Slovakia exceed 30 000 while less than one third of them is active, according to the estimates. The third sector, namely the large and well established NGOs with a good reputation, were well prepared for structural interventions because of their previous experience with pre-accession funds and other donors' grant schemes. The Structural Funds assistance was expected to become one of the main sources of NGOs' funding after accession, when development aid funding ceased and other alternative sources were scarce. Besides grant recipient status, the involvement of the third sector, due to the required partnership principle, was also expected in the planning stage and/or NGO representation was envisaged in the Monitoring Committees.

The study conducted by Brian Harvey (2004) entitled "Illusion of Inclusion" examined the situation in the new EU Member States namely because of concern that the loss of EU pre-accession funding and grant schemes to develop civil society, as well as the withdrawal of foreign foundations from the region would threaten the sustainability of a fast-growing but still relatively fragile third sector. The report conclusions mentioned that NGOs were named as beneficiaries in too few measures of the OPs, and if so, it was in programmes where their effective opportunity to obtain funding would be limited (e.g. in measures designed for private enterprises). Overall, the prospects for NGOs to obtain a substantial share of the structural funds allocated for 2004-2006 were poor. This was, in some countries, caused by unrealistic requirements for co-funding but, in general, little effort was made to facilitate the NGOs' access to the funds. The consultation process during the preparatory phase with the third sector was not systematic but there were some examples of good practice.

The initial design stage of the Slovak Structural Funds programmes was prepared in partnership with NGO representatives. Later, however, the National Development Plan was substantially changed and the number of OPs was significantly reduced. The approval procedures took place under considerable time pressure in order to commence rapidly with implementation. The final design was thus approved without any possibility for the NGOs' to comment on the changes. Eventually, the NGOs found the management and implementation of structural funds interventions insufficient. According to them, it suffered from numerous problems and was marked as inconsistent, non standard,

difficult to understand and confusing. The recent experience shows that although there were some improvements, the general perception of the EU Structural Funds projects, reported by the majority of final beneficiaries from NGOs, is that they are too bureaucratic with excessive, unclear and complicated administration, lengthy approval procedures and late payments.

In 2005 the European Citizen Action Service, which is the international non-profit organization lobbying for the NGOs interest, presented a paper on the NGOs role and contribution to the EU cohesion policy. It also included expectations of the third sector and/or a proposal to simplify structural fund procedures in order to make EU cohesion policy more transparent and to facilitate its understanding by citizens and access by civil society. It was assumed that the Structural Funds will be more decentralized and less complicated, with a reduced number of objectives (ECAS, 2005).

Overall, the NGOs in Slovakia were set out as eligible beneficiaries in less than one third of all 32 measures (1 of the 11 measures in the OP Agriculture and Rural Development; 6 of 8 in the OP Human Resources; 2 of 4 in the OP Industry and Services; and 3 of 9 in the OP Basic Infrastructure). Again, this should be treated cautiously, as, for example, the OP Industry and Services set out that the eligible applicants were expected from business partnerships and associations (ECAS, 2005). In the new programming period the possibilities of NGOs to apply for the funding from ESF sources got further reduced. In the OP Employment and Social Inclusion only 4 of 11 measures mention NGOs as eligible applicants, in all other OPs it is substantially less or NGOs are not eligible applicants at all.

Therefore, when talking about the evaluation of the NGOs Structural Funds interventions, we will concentrate on ESF support from the previous programming period (data from the current programming period is very preliminary). The experience of NGOs EU grants within the new programming period in Slovakia is so far quite limited, but, if an improvement related to the administration of the projects is reported, then it is due to the experience gained in the past, rather than decentralization or simplification of the procedures. Based on the available data, roughly 35 % of the grant recipients of ESF funds managed by the MoLSAF, and some 10 % of grant recipients of ESF funds managed by the Ministry of Education, were NGOs. The third sector's share is not very high, which is most likely caused by the administration requirements and the need to have sufficient financial sources for the implementation. These two conditions could not be secured by the small NGOs.

6.4 NGOs and Impact Evaluation

It is practically impossible to report the actual benefits, effects and impact of the support provided to the NGO sector through structural interventions for several reasons. As already mentioned, the evaluations are not very frequent, and those that have been conducted have limitations that do not enable them to answer this question. None of the evaluations conducted so far have specifically focused on NGOs and very

few attempts have been made to map the impacts in general. Moreover, international experience shows that measuring the impact of NGOs grants is not an easy exercise and suffers the same problem with indicators.

“Searching for Impact and Methods: NGO Evaluation Synthesis Study” is the most comprehensive overview of NGO impact and impact evaluation methods. Although it is not very recent, its results could be generally applied to the NGOs’ structural interventions impact too. The study looked at evidence from 60 separate reports on 240 projects undertaken in 26 developing countries. The conclusion, confirmed by data and interviews, was that in spite of a growing interest in evaluation, there was still a lack of reliable evidence on the impact of NGO development projects and programmes, namely because the data was exceptionally poor and reliable evidence was missing. The studies were examined in relation to the different factors influencing project performance. These were generally the factors equally influencing the structural interventions and were related to the external factors and basic conditions to implement the projects such as competent/professional staff, good project design and planning, adequate management, administration, local capacity, sufficient funds and time to achieve objectives (Kruse et al, 1997).

Similar deficiencies were reported in the summary report of the Slovak Central Coordination Authority on the results of evaluations undertaken within the ESF programme in 2008 (MVR SR, 2009). The recommendations of the evaluation reports, aimed at the improvement of the Structural Funds implementation in the programming period 2007-2013, referred to the improved and unified system of indicators and their quality, the input of the data for indicators into the monitoring system enabling regular on-going monitoring of the indicators achievement, analytical tools for monitoring indicators (at the level of measures, priorities, various groups of final beneficiaries etc.), improved monitoring of financial sources as well as the continuity of human resources in the Structural Funds management and improved public awareness.

The summary of evaluation assignments carried out in the period 2006-2009 within the ESF OPs (see table below) also suggests that all of the evaluations were very small assignments (in terms of financial value) with a short duration and an inappropriate number of evaluation questions and thus could hardly provide the necessary in depth analysis.

Table 6.1 Types of evaluation in Slovakia

Type of evaluation	Period	Value in EUR	Year	Duration months	No. of ev. questions
Interim evaluation report for Programming document IS EQUAL ¹	2004 - 2006	19 916	2006	2	0
Balancing disparities among individual regions SOP HR and districts of region SPD NUTS II BA objective 3 due to the focus and impact of projects implemented in respective regions in the shortened programming period 2004-2006	2004 - 2006	25 675	2008	2	5
Evaluation of the indicators' achievement in comparison with previous years (2004-2007) in relation to the achievement of individual measures of SPD NUTS II BA objective 3 ²	2004 - 2006	20 740	2008	2	-

Type of evaluation	Period	Value in EUR	Year	Duration months	No. of ev. questions
Evaluation of the implementation status of SPD NUTS II BA objective 3 in the period January 2004-June 2008 from the perspective of the competitiveness increase in Bratislava region through the human resources	2004 - 2006	17 775	2008	2	-
Evaluation of the implementation status of SPD NUTS II BA objective 3 in the period January 2004-June 2008 from the perspective of global and specific objectives achievement of SOP HR including the assessment of the ESF financial sources	2004 - 2006	22 515	2008	2	-
Completion of the evaluation of the implementation status of SOP HR in the period June 2008-December 2008 from the perspective of the employment increase based on the qualified and flexible work force and final evaluation of SOP HR	2004 - 2006	11 900	2009	2	75
Completion of the evaluation of the implementation status of SOP HR in the period June 2008-December 2008 from the perspective of the competitiveness increase in Bratislava region through the human resource development and final evaluation of SOP HR	2004 - 2006	7 620	2009	2	75
Final update of the status and benefits of the Community Initiative programme EQUAL through the interim evaluation report	2004 - 2006	29 700	2009	2	58
Ex-ante OP Research and Development*	2007 - 2013	6 640	2006	-	-
Ex-ante OP Education*	2007 - 2013	44 712	2006	-	-
Ex-ante OP Employment and Social Inclusion within ESF*	2007 - 2013	74 850	2007	2	>50
Evaluation of the suitability of the indicators' system and its use in the OP Employment and Social Inclusion	2007 - 2013	15 500	2009	-	65
Efficiency evaluation of the OP Education*	2007 - 2013	9 900	2009	6	34

* Report was not made available.

Source: authors

The Terms of Reference for these evaluations either did not mention any specific evaluation question or they showed a long list of questions that could not be properly responded to within the given time frame. Unfortunately, not all of the reports have been made available (published on the web page) therefore only half of the reports could be analysed. With the exception of the ex-ante evaluations, the reports mostly focused on management issues, gathering data for the obligatory reporting or setting up indicators, but none of them focused on the results and impacts achieved. Where this was specifically asked, the reports often stated that the indicators were not available to assess the achievements, or the effort to gain some primary data largely failed because the final beneficiaries did not respond in time and/or could not be reached any longer.

The reduction of the selection criteria in the evaluation tenders to the price quotation, regardless of the methodology and thus potential quality of the outputs, puts no pressure on the bidders to pay attention to the methodologies applied in their proposals. In most

cases the evaluation reports did not specify the methods applied. Based on the content, we can assume that most of them used desk review, occasionally interviews and questionnaire survey instruments (mostly focused on the staff of the management bodies, usually with a low response rate when addressing final beneficiaries). Nevertheless, the progress or trends to apply more sophisticated evaluation methods have not been identified. The majority of evaluation reports are based on secondary data, which is found to be incomplete, insufficient, unreliable, not quantified or not monitored; however, such limitations of the methodologies are not mentioned.

Despite the deficiencies in methodology and analysis the final conclusions of the various evaluations are very positive and usually consider the objectives to be achieved (reporting increased employability, qualification and adaptability, competitiveness, etc.) and the benefits to be sustainable. Equally, where possible and data was available, the indicators were also reported as achieved, although their relevance was questioned. Figures supporting such positive conclusions were supported by the general statistics available for 2008, a year when the economic development of the country progressed well and the unemployment rate dropped. However, there has been no attempt to determine the net contribution of the structural interventions.

The utilisation of evaluations is questionable. As already mentioned, no formal mechanisms ensuring the recommended measures are adopted have been established. So far, the evaluations do not serve transparency or accountability purposes. Their primary aim was to improve administrative procedures or assist the management bodies with the obligatory reporting. Many of the recommended measures were submitted at a time when the administration of the programming period was already set up. Moreover, some of the procedures are adopted centrally by the Government and the management bodies can interfere and change it only within their limited scope of responsibilities. An important factor for the use of the evaluations is their perception, which is positive in those countries with a long history of evaluations but opposite in countries with little or no evaluations history.

An interesting example can be demonstrated in the following case. PISA (Programme for International Student Assessment) regularly tests students. A few years ago such benchmarking did not show very positive results for the Slovak Republic but also some other countries like Austria and Denmark. It was up to the national bodies to take the corrective measures. Following the results of benchmarking Denmark adopted legislation requiring all schools prepare annual self-assessment reports and submit them to the Ministry in order to monitor progress. Austrian specialists started discussion on the applied methodology and its limitations to provide correct results. The Slovak Republic decided not to participate in the following benchmarking.

Apart from locally launched evaluations, the EC and its DG Employment is running numerous evaluation assignments. The national bodies are made aware of these evaluations but so far have not shown any particular interest to take them on board.

6.5 Expected Future Development

To predict the future development of evaluation in Slovakia and Czech Republic is a challenging task. So far the strong external pressure from the EU has not managed

to stimulate internal pressure and to anchor evaluation as an inseparable part of the policy cycle and good governance. Bottom up pressure has been initiated: activities to promote evaluation and its use are being organised by the national evaluation society. Training is widely available and its use depends on the policies applied by the individual ministries and the willingness of the staff to participate. Top-down pressure is, however, still lacking and Slovakia needs an “evaluation champion” with the power to install this important instrument for informed decision making in governance. The proper utilisation of the evaluation could thus improve the transparency of public administration, serve accountability purposes and ensure the efficient, effective and justified use of public funds as well as to provide lessons for the future.

Facing the impact of the global financial crisis and EU internal problems, most countries will seek tools to reduce public expenditures. The use of evaluations is one of the most convenient tools, although not universal. Another well tested way to shrink public administration and related expenses is outsourcing the services. Above all, social services are often contracted to the NGO sector, which proved to be more flexible, ready to introduce innovative approaches, better able to respond to the client needs and more cost effective than the cumbersome administrative machineries. Many of the countries have been using such contractual relations. To undertake such tasks, the third sector has been improving its absorption capacity and capability with the assistance of structural interventions. However, easier access and reasonable administration requirements are needed to speed up this process.

Numerous tools have been introduced in the EU countries to stimulate the participation of NGOs – starting with the simplification of the application process, reduced administration requirements for projects (using lump sums, unit costs, etc.), up to the availability of small grants to very small or even informal associations without any obligation to provide financial reporting. The room for improvement is namely in the area of developing partnership and establishing cooperation and/or mutual trust among the administration, NGOs and citizens.

The evaluation culture in the Czech Republic and Slovakia has been developing since the pre-accession tools. Although it has been quite a long time, there is still a lack of experience with evaluations in those countries on the sides of both demand and supply. The managing authorities sometimes do not understand what kind of evaluations to do and for what purpose. On the opposite side, the evaluation teams sometimes do not know how to do a proper evaluation and which methods are appropriate. Many evaluations have not used appropriate tools and methodologies.

The managing authorities of the operational programmes have only seen evaluations as a requirement from the European Commission. The managing authorities did not usually use evaluations as a tool for improving or implementing the programmes or assessing their effects. Such a situation is obvious not only in the Czech Republic and Slovakia, but also in other Visegrad countries. Thanks to the Structural Funds, at least some public authorities have become more familiar with evaluations, although it was a new element in the public expenditure programmes.

We expect evaluations to spread to other public expenditure programmes beyond the scope of the EU funded interventions. We expect such a development (increased use of evaluations) not because of the passion the governments have for the evaluations, but



due to economic pressure. The lack of funds in public budgets will hopefully increase the awareness about evaluations. Evaluations can then help improve the effects of public expenditures and save scarce financial resources.

Progress is also expected in developing new and more suitable methods of evaluations. This is obvious from the discussion in the evaluation community across Europe concerning counterfactual impact evaluations and an appropriate method for evaluating the impacts of the Structural Funds assistance.



IMPACTS OF THE STRUCTURAL FUNDS ON THE CAPACITY OF NON-PROFIT ORGANIZATIONS IN VISEGRAD COUNTRIES

Since 1989 Civil Society has developed rapidly in the Visegrad countries (Poland, Hungary, Slovakia and the Czech Republic). The Western donors, both private and governmental, have played a major role in the initial development of Civil Society organizations. The financial assistance from these donors was welcomed and appraised as vitally important for local institutions (Regulska, 1998). Foreign donors helped non-profit organizations to build infrastructure, and transfer a western style of thinking to them (North, 2006, p. 36).

The more the non-profit sector in these countries was developed and stabilized, the more international organizations and donors turned their attention to countries with higher needs and problems. This step was also connected with the Visegrad countries' accession to the European Union. The Copenhagen criteria for accession also included a stable democratic political regime. The accession of the above-mentioned countries into the EU in 2004 was a proof of their democratic stability. However, it has also been milestone for the foreign donors. The departure of these donors caused considerable problems for the Civil Society organizations previously supported in the countries in question.

The outflow of foreign donors still continues. The volume of funds from those donors continues to decrease in Central Europe. This outflow is discussed more in detail by Quigley (2006). On the other hand, accession brought new financial opportunities for Civil Society, those being the EU Cohesion Policy.

According to Laboutkova (2009, p. 25), Structural Funds haven't fully replaced the previous funding of the Civil Society for three reasons. First, foreign donors provide funding for nongovernmental organizations (NGOs) relatively quickly. The procedures for appraisal and controls were quick and easy to manage. Thus, funding was available even for small organizations, this is the opposite of Structural Funds assistance. Second, the resources provided by foreign donors allowed a considerable degree of freedom in setting objectives by the supported non-profit organizations. The rules were more flexible and less stringent. Third, it is a focus area of assistance. The foreign donors provide funds for organizations supporting democracy in the promotion of public interests, human rights, etc. The Structural Funds are not intended to assist those fields.

Despite this, the Structural Funds became one of the major sources of funding for local NGOs in the Czech Republic. Non-profit organizations have learned to use this resource, although it is not always easy for them.

There are two main causes for the poor use of Structural Funds by the NGOs. One of them is the NGOs lack of financial capacity. The NGOs cannot afford to back up or co-fund suitable projects. The other reason is the lack of personnel capacity. NGOs are not able to prepare and implement demanding projects to ensure administration and documentation by themselves (Berman Group, 2005).

This chapter deals with the financing of NGOs from the EU Structural Funds in terms of their financial, managerial and personnel capacities, especially in the Czech Republic and Slovakia.

7.1 The Development of Civil Society in the Czech Republic and Slovakia

In order to analyze the influence of EU Structural Funds on the Slovak non-governmental organizations (hereinafter NGOs) during the period of 2004-2006, we have to look closely at the historic background of NGOs in the society and the role they have played in influencing public discourse, politics, decision-making, as well as policy design. For the purpose of this analysis, we do not need to go back to the pre- and post-war era and it would suffice to focus on the period after the fall of communism in 1989.

An important aspect of the third sector's performance in the transition period is the active participation of the civic movement *Civic Forum*, respectively its Slovak counterpart "*Public Against Violence*" during the 1989 Velvet revolution, and its involvement in forming the first post-communist government of Marián Čalfa. We can speculate about the real impact and influence of the various groups of civic activists on the actual shift of power, however, we need to bear in mind the capacity of the dissent elites and their successful attempt to transform their movement into a political entity, which gained a landslide election victory in summer 1990.

Ironically, it is the former Prime Minister Vladimír Mečiar whose policies and politics influenced the structure, objectives, scope of activities, capacity, funding and performance of the third sector in Slovakia in the late 1990s and early 2000s. In the period 1994 to 1998, Vladimír Mečiar's third government led Slovakia into international isolation in which the accession process to NATO and the EU were postponed. The corruption was stimulated via the uncontrolled privatization of state-owned enterprises, as well as abuse of both the secret service and the media for political gains. The aforementioned rifts between state and civil society on the issues of democracy and civil rights established a strong need for change. In a reflection of this process, the third sector started to mobilise its capacities with the aim of protecting democratic values and freedom of speech in Slovakia. At the same time, NGOs helped to activate citizens to take part in the elections in September 1998, in order to cast their vote for the future of the country.

As mentioned earlier, the objectives of many NGOs shifted to preserving the existing democratic rights. Their activities ranged from cultural events, political discussions and debates up to student marches. The quality of human resources in the third sector gained from the situation, as many experts joined various NGOs due to the loss of jobs in the public sector, often caused by their civil and/or political activism. One of the crucial pre-conditions for the NGO boom was the funding provided to the NGOs. Major overseas donors, in combination with Bratislava based Embassies, formed the financial backbone for the rise of the new NGOs.

The landslide victory for the opposition (gaining a constitutional majority) was nothing but a success for Slovak NGOs.

During the first Mikuláš Dzurinda government (from 1998 to 2002), the NGOs played an important role in the democratisation process. The third sector's capacities and know-how were used, for example, in drafting new media laws, the Freedom of Access to Information Act (FOIA), and others.

The formation of the second Dzurinda government (from 2002 to 2006) with a strong pro-reform programme had a severe impact on human resources and thus on the ca-

capacities of NGOs in general. The brain drain of the third sector occurred mainly due to the following two reasons: Firstly, many third sector experts joined the government and participated in designing and implementing the reform agenda. Secondly, a booming economy brought new possibilities and demands for educated people in the labour market. Together with scarce financial resources, these were the main impetuses for exiting the third sector. In contrast to the first, the second Dzurinda government launched the EU Structural Funds in the period 2004-2006.

The boom of NGOs in late 1990s and early 2000s is illustrated in Table 7.1, based on the International Qualification of NGOs. The number of NGOs almost doubled during this period. The Slovak Statistical Office in its National Qualification has provided data giving a clearer picture on the rising number as well as the structure of the increase (Table 7.2).

Table 7.1 Number of NGOs in Slovakia

Number of NGOs		
Year	1996	2002
Total	14 194	26 770

Source: *International Qualification of non-profit organizations (Filadelfiova et al (2004))*

Table 7.2 Number of NGOs in Slovakia – National Classification

Year	1999	2000	2001	2002	2003	2004
SR in total	17 814	21 282	23 566	26 210	26 106	29 260
Associations	9,942	11,685	12,903	14,654	14,588	16,346
Clerical organizations	2,986	3,270	3,356	3,128	3,122	3,120
Home-owner organizations	3,335	4,614	5,426	6,304	6,334	7,013
Foundations	456	491	518	530	402	429
Interest groups	392	504	575	614	611	751
Non-investment funds	230	279	297	341	370	426
Professional associations	205	218	225	141	116	106
Health care organizations	-	-	-	-	53	288
Not classified elsewhere	268	221	266	498	510	781

Source: *Statistical Office*

Even though we cannot compare the data from Tables 7.1 and 7.2, we can see an increasing trend between 1996, 1999 and 2002. As to the structure, the increase was mainly supported by the rising number of associations and home-owner organizations. The numbers only show the trends, however, it is hard to estimate the real number of NGOs as many of the recorded organisations are no longer active and thus could not be included in the total number.

The situation developed in different manner in the Czech Republic. Although the development was also influenced by the political system, Civil Society was not suppressed as in Slovakia. There were lengthy discussions about the role of the political parties and

civil society in the political-decision-making. A proponent of civil society and engaging the public was the former president of the Czech Republic, Václav Havel. On the contrary, Václav Klaus, the former prime minister and current president represents the opposite approach. The arguments are based on the options for civic engagement through the political parties and elections. This topic is discussed more in detail in Frič (2004).

The following table explains the development of the Civil Society organizations in the Czech Republic. There is a clear, gradual increase in the number of Civil Society organizations. It is necessary to point out that there are many (probably a majority) of NGOs, which are formally registered, but are inactive.

Table 7.3 Development of Civil Society in the Czech Republic

Legal form	Number of organizations				
	2003	2004	2005	2006	2007
Foundations	227	250	293	307	302
Endowment Funds	534	573	725	650	697
Public benefit organizations	376	610	511	742	879
Civic Associations	50997	53306	54963	58347	61802

Notice: Numbers of Foundations, Endowment Funds and Public benefit organizations are based on the Czech Statistical Office statistics. The number of Civic Associations is based on ICN statistics.

Source: Czech Statistical Office (Task: NI 1-01 (a, b); Selection: ISEKTOR 15000), ICN

7.2 Financial capacities of NGOs

Rose-Ackerman (2007) points out that NGOs in Central European countries have insufficient financial and personnel capacity. It is difficult for them to get the necessary funds to finance their activities, even to pay salaries to the permanent staff.

A USAID study (2008, p. 94) mentions that more than 80 % of Czech NGOs are dependent on one or two sources of funding. The main source of funding of Czech NGOs remains public budgets, despite considerable efforts to ensure that non-profit organizations learn to seek funding from other sources. The situation is similar in Hungary, where most of the NGOs receive funds from one or two dominant sources, and increasingly rely on bridging loans because of cash-flow problems (USAID, 2008, p. 116). Similarly, the majority of Polish organizations have a low diversity in their sources of funding. Small local organizations are dependent on local government resources.

These organizations did not try to diversify their sources of funding in the first programming period in the Czech Republic (2004-2006) as they relied on the Structural Funds. But those funds were targeted at large projects with higher costs. Thus, the long-term-functioning organizations with sufficient capacity were able to get funding (USAID, 2008, p. 181).

The small and poor non-profit organizations are trying to adjust their activities according to the priorities and topics of the available grants. Their strategy is to plan where and when the individual NGO can apply for funds. On the contrary, the bigger organizations simply seek resources, which would promote the development of their activities (USAID, 2008, page 180).

7.2.1 Co-financing

Insufficient financial and personnel capacities are also reflected in the smaller number of applications for programmes that require some degree of co-financing. Often, even the relatively small financial contribution required from the NGOs for co-financing, is a deterrent for many organizations, which has been evident for example in the Joint Regional Operational Programme in the Czech Republic in the previous programming period 2004–2006. It was necessary to ensure co-financing of at least 10 % of the total project costs in that programme. This resulted in a situation where some of the NGOs became less interested in projects assisted by the EU programmes (Soukupova, 2007, p. 39)

Difficulties in obtaining co-funding for projects may be due to their lower quality or limited knowledge of the NGOs' planned projects. They may be also caused by little knowledge of how and where to obtain the necessary funds. This ignorance can be eliminated if the organization gains know-how on the proper use of fundraising. In addition, according to a study prepared by RVNNO (2008, p. 25), the situation is so bad that non-profit organizations do not even have enough money to finance fundraiser jobs to find and acquire additional resources in the Czech Republic.

According to Holy (in Kundrata, 2007, p. 66), other way of dealing with the situation regarding the financing is to allow NGOs to include in kind expenditures, such as work of volunteers, as a necessary co-financing. This practice would enable weaker organizations working only with volunteers to apply for the funding. There is a majority of such volunteer-based organizations in the Czech Republic and other Central European countries. Thus it would be a solution for them.

There is such an advantage for NGOs that the subsidies cover all expenditures of the projects in the Czech Republic. This is relevant especially in case of the European Social Fund. Thus, the programmes financed by this fund are very popular among NGOs.

On the other hand, the previous programming period showed that the projects of NGOs, as well as those of public authorities, had the same feature. They have benefited from a low level of co-financing. Thus, there was almost no emphasis on the projects' effectiveness. However, the applicants from business sphere were required to implement activities, which had about 50 % of funds from their own resources. Thus they implemented projects with greater effort to use them efficiently (Holy In: KUNDRATA, 2007, p. 66).

7.2.2 Advance Payments and Covering the Expense of the Projects

From the perspective of NGOs it is not just the amount that is important, but also the manner of payments. It makes a difference for the NGOs if the payments come as advanced payments or ex-post payments.

Not all of the operational programmes offer the advantage of advance payments. Some require the project to be implemented first and then the grant is reimbursed retroactively. Churski (2008, p. 600) sees advance payments as the biggest problem in the use of the Structural Funds by Polish NGOs.

Non-profit organizations are not able to build up sufficient financial reserves to finance the project from their own resources before receiving grants. For example, in Poland 75 % of NGOs do not create any reserves (USAID, 2008, p. 181).

At the same time, for most organizations it is not possible to obtain the necessary funding or loans from banks. NGOs do not have any assets, which could guarantee the bank loan.

In the Czech Republic there were even cases of the statutory representatives of NGOs offering to support their NGOs by a loan guarantee using their own property. That was the only way for the organizations to get some loans and to implement the project (RVNNO, 2008, p. 20).

The NGOs in Hungary have had similar experience. The NGOs had to take mortgages, or people from their management or staff members took personal bank loans to cover the projects' expenditures (USAID, 2009, p. 117). Moreover, interests on the loans are not included as eligible project costs and must be therefore paid by the loan and mortgage recipients themselves.

This approach of some managing authorities virtually excluded NGOs from benefiting from the Structural Funds. The Czech Civil Society Development Foundation (NROS) is trying to solve the problem. It introduced a new programme together with the Postal Savings Bank Inc. The programme called "3P" (Bridging Assistance Program) brought loans for NGOs. This programme enabled non-profit organizations to obtain loans to ensure smooth cash flows during the implementation of projects granted from the state budget, regional or the Structural Funds.

Many of the non-profit organizations that succeed in their applications for EU funds often complain about delays in the payment of the grants awarded. Even a small delay in payment can threaten project implementation, because NGOs are not able to replace these cash shortfalls from their own resources in most cases (RVNNO, 2008, p. 20).

According to USAID (2009, p. 117) the delays of payments to Hungarian NGOs are caused intentionally by their government. The government has its priorities in supporting the business sector during the economic crisis. NGOs capacity building is left behind.

On the other hand, a number of non-profit organizations have been forced to seek the necessary funds elsewhere because of frequent problems with reimbursement grants already awarded. This led to development of fundraising abilities of these organizations (USAID, 2009, p. 94).

7.2.3 Financial Sustainability

According to Gajdos (In: KUNDRATA, 2007, p. 107-108), NGOs often did not know how to build their capacity in the Czech Republic. They were quite often unaware of their own long-term strategy, for which they needed to build their capacities. They considered solutions for their customers to be most urgent and refused working on strengthening their own capacities. The strengthened capacities would have allowed them to stabilize the situation in their organization and reduce the risk of going bankrupt.

The financial sustainability of the Czech NGOs has deteriorated since 2004 according to USAID (2009, p. 95), It is partially connected with the accession of the Czech Republic into the EU and the Structural Funds assistance.

A large part of the Czech NGOs has been focused to raise funds from public sources in the long-term. It's convenient for them, of course, because fundraising from other sources is worth far more effort. The situation is similar in Poland (USAID, 2009, p. 179).

State subsidy policies as well as subsidies from the counties and municipalities do not allow projects to be planned for a period longer than one year. This is due to the annual budget and political approval of the allocation of resources. NGOs have to submit their requests for support from the public budgets again and again. They do that without being sure of receiving the required amount. This principle causes long-term problems in developing the voluntary sector both in terms of services offered and activities in the field of human resource development (Kucerova In: KUNDRATA et al., 2007, p. 32).

The Structural Funds are a little more helpful for the NGOs in this regard. The Structural Funds allow non-profit organizations to raise funds for their activities for a period longer than one year. These resources can also be used to finance small investments, especially in office equipment, etc. (Janouskova, Skarabelova and Vesely, 2008, p. 16). Thanks to this option the technical skills of Polish NGOs have been improved (USAID, 2009, p. 182). However, it is often more difficult to get such funds for non-profit organizations.

Some experienced organizations that have learned to fill out applications properly and then to manage the projects, have become regular applicants for subsidies from EU Structural Funds. These funds then form a significant part of those NGOs' financial resources. In Poland, many of the larger organizations become dependent on EU funds (USAID, 2009, p. 182).

However, focusing on these resources does not provide sufficient financial stability and sustainability for the NGOs. This has been shown, for example in the Czech Republic in the transition from the previous programming period 2004-2006 to the present programming period 2007-2013. The first programming period for the CEECs has ended, but the programming documents for the new programming period have not yet been prepared, so that some NGOs have lost the chance to build upon the projects realized with assistance from the Structural Funds.

Moreover, problems have been compounded by the fact that the new priorities and support for various operational programmes did not match their predecessors from the previous programming period. For NGOs it was mainly the case of the OP HRD and its "successor" the OP HRE (Janouskova, T., Vesely, 2008, p. 10-11). Delays by managing authorities in preparing new programming documents caused significant problems for NGOs and some of the NGOs' activities had to be greatly reduced or even disappeared.

The sustainability of the projects' outputs is a major problem for projects receiving funding from the Structural Funds. Sustainability is a requirement, the NGOs often fail to keep up with even the best outcomes (RVNNO, 2008, p. 20).

The principle of sustainability is one of the basic requirements that an organization receiving a grant has to meet. It is, however, no exception that, the organization fails to continue financing the supported activities after the end of funding from the Structural Funds. Very often the non-profit organizations fail to keep the outputs. They are not able to sustain the activities without receiving additional funding. Some organizations address these issues by pricing their services (ELBONA; AKSES, 2006, p. 169). This is a case of good practice as the NGOs are counting on the sustainability of their activities.

The issue of sustainability is discussed among experts and implementation bodies. The question is whether it is appropriate to punish those organizations or reduce subsidies in such cases when the organizations fail to comply with the sustainability of projects. It could cause a deterioration of services for disadvantaged groups (IDEC SA, 2006, p. 54).

7.3 Financing of NGOs in Slovakia

Slovak NGOs, as similar organizations in the region, are suffering from financial insufficiency for various reasons. Financing of NGOs in Slovakia has undergone some major shifts and changes, reflecting the structure of donors and revenues. We have identified three main factors leading to a change in the funding structure: Firstly, the behaviour of donors – moving in and out. Secondly, the introduction of the 2 % Income Tax Assignment Scheme. Thirdly, the introduction of the EU pre-accession and EU Structural Funds.

From 2000-2002, in a reflection of the first aforementioned factor, a debate on the sustainability and diversification of third sector financing took place. NGOs lobbied in favour of a partial use of privatised revenues¹⁶ for the capitalisation of foundations, thus creating a new source of funding for NGOs. Instead, the government introduced a 2 % income tax assignment.

The entrance and exit of large, mainly overseas private donors together with support from Bratislava-based Embassies in the Mečiar era, led to an increase in the number of NGOs. The support was easily absorbed. In contrast (as expected), the movement of the donors out of the country and further to the east caused a number of NGOs to close down due to their inability to cope with the changing funding structure and demands. What do we mean by that?

The process of the slow exit of larger donors from Slovakia drained the resources for a wide scope of NGOs. The position of small and medium sized NGOs was weakened and many of them had to shut down. The ability to diversify their funding sources was very limited as there was no real capacity for strategic fundraising. Concurrently, new resources were not available. Pre-accession funds were no option for smaller NGOs as their focus was more on the medium and large sized organizations with a large information asymmetry in favour of strong, Bratislava-based organizations. Therefore it can be established that the introduction of the pre-accession and EU Structural Funds have had an intense impact on the structure of third sector funding.

2 % Tax Assignment

The 2 % Tax assignment was introduced in 2002. This tool has given individuals the right to assign 2 % of their income tax to an NGO. In 2004, as a part of the tax reform, corporate entities received the same right. Table 7.4 illustrates the growth in total revenue based on the aforementioned tool.

Table 7.4 NGOs Revenue from 2 % Tax Assignment (in thousands of SKK)

Assignee/Year	2002	2003	2004	2005	2006
Individual	101 882	97 070	275 917	298 999	312 439
Corporate	-	-	569 256	579 393	618 439
Total	101 882	97 070	845 173	878 392	930 878

Source: Slovak National Tax Office

We have added information concerning donation activities for the Civil Society organizations in the Czech Republic for a comparison. It is possible that there are much more

¹⁶ mainly the privatisation of SPP (Slovak Gas Industry) by E.ON Ruhrgas and Gaz de France

individual donors in the Czech Republic in comparison with the published information. There are probably many tax payers who do not know about the possibility to lower his/her tax burden by donating to NGOs. There is also a possibility that some donors do not meet the criteria of Act No. 586/1992 as there is a limit for donation from 2 % to 10 % of the tax base.

Table 7.5 Amounts of donations mentioned in tax declaration according to the Czech Ministry of Finance

Year	Number of donors (persons)	Donation (bln. CZK)	Average donation (in CZK)
2000	71496	0,67	9371
2001	78191	0,76	9720
2002	102811	1,00	9678
2003	89274	0,91	10205
2004	92885	0,98	10561
2005	121469	1,19	9797
2006	132236	1,34	10118

Source: RVNNO (2008b), p. 24

The introduction of the 2 % tool has brought forth several pros and cons. Among the positive effects, we include the following: The 2 % Tax assignment emerged as a new funding source mainly for small and medium sized NGOs. Based on interviews (there are no other relevant data), we can conclude that it has increased the participation of people at a local level as they could financially support their local activities, leading to being more involved in the community. Furthermore, it has allowed NGOs to diversify their financial resources into another pillar.

Among the negative effects, we include the following: An introduction of a tool creates the impression of being a sufficient tool for NGO-funding in Slovakia, which is, however, not true. This tool does not cover all types of NGOs as people and corporations tend to allocate their taxes into classical areas, therefore tending to be conservative in their selection. The tool as such is very limited though for the overall funding strategy of NGOs.

Pre-accession Funds

The pre-accession funds were introduced during the Mečiar Government and their implementation continued during both Dzurinda governments (as well as after the accession to the EU). Slovak NGOs could apply for the following funds:

- PHARE – Cross-border cooperation
- PHARE – ACCESS – supporting NGOs in two areas: environmental protection and socio-economic development
- PHARE ACCESS – Networking Facility
- PHARE – Small Projects
- PHARE – Regional environmental project
- PHARE – Civil Society Development Program
- PHARE – Development of National Minorities Program
- Program SOCRATES

- Program LEONARDO DA VINCI
- SAPARD – Rural Development Program
- Program YOUTH
- Program CULTURE 2000
- Pilot Grant Scheme for Tourism Development

As mentioned by many interviewed experts, pre-accession funds were supposed to build the NGOs' capacity to absorb larger amounts after the accession. However, the whole system was not well designed and improperly managed, which erupted with the case of Roland Tóth, Director of the Foreign Aid Department at the Government Office in the years 1997-2000, accused of misusing his competencies, which however has never been proved (Bercik, 2002). Annex 1 shows the support for all pre-accession programmes from 1995 to 2005.

Structural Funds

Unprecedented amounts of money started to flow into the country with the accession to the EU in May 2004. Slovakia, together with another 10 EU countries was eligible for participating in the financial period of 2000-2006 with regard to the use of EU Structural Funds. The total amount of money allocated for Slovakia in the given period was 1 560 million EUR.

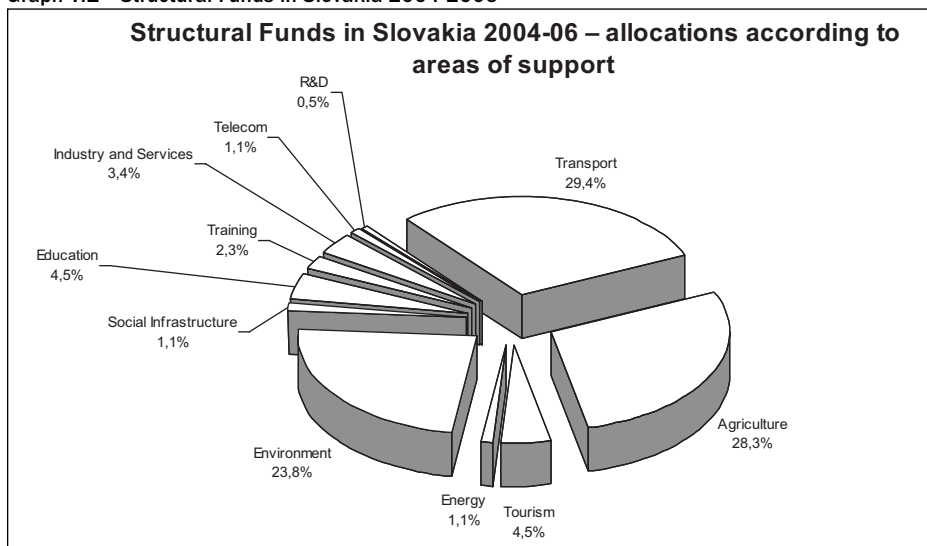
Funds were distributed based on the National Development Plan (MVRR SR, 2003) via four sectorial operational programmes (hereinafter SOP) and one regional:

1. Industry and Services
2. Basic Infrastructure
3. Human Resources
4. Agriculture and Rural Development
5. Single Programming Document for the Bratislava Region – Objectives 2 and 3

The SOPs were designed as larger programmes with many measures covering different areas/priorities. For a better understanding, we have divided the support to eleven areas based on the content and put them into pie chart no. 1 based on the financial allocations.

The NGOs were defined as the final beneficiaries in one measure in the SOP Industry and Services, in three measures in the SOP Basic Infrastructure, furthermore in seven measures of the SOP Human Resources and three measures in the Single Programming Document.

The NGOs were also eligible for funding under the cross-border programmes INTERREG with Austria, the Czech Republic, Hungary, Poland and the Ukraine as well as under the Initiative EQUAL financed by the European Social Fund (hereinafter ESF). Table 7.6 shows the overall participation of the NGOs in each program. What can we conclude from these numbers? The NGOs implemented a project in three operational programmes, the EQUAL Initiative and three cross-border programs. The largest amount in spending by the NGOs, both in nominal value as well as relative was recorded in EQUAL. The whole scheme is designed to provide services in areas, which are usually covered by the third sector, such as civil rights, gender issues, social inclusion etc. Support to the NGOs in total nominal amounts was also high in the SOP Human Resources, the SOP Basic Infrastructure and

Graph 7.1 Structural Funds in Slovakia 2004-2006

Source: author based on the National Development Plan

the Single Programming Document for the Bratislava Region under Objective 3 (hereinafter SPD Bratislava).

Based on our research and interviews, we have identified several pros and cons of EU Structural Funds with regard to the support to NGOs, their capacity building and the ability to absorb large resources.

EU Structural Funds were approached with big expectations from the third sector and, due to the allocated amounts, were also believed to be the alternative to the draining of private resources. The Operational Programmes opened new areas of activities and motivated NGOs to restructure their objectives and also their mission. Widening the scope of the third sector activities together with possible funding via Structural Funds has had a positive impact on the expert portfolio of various organizations. Contrary to this, we have identified three main cons. Firstly, the capacity of NGOs to implement the EU Structural Funds projects was very limited. Secondly, the system of project implementation was set up improperly, with too many administrative obstacles, thus leading to inefficient management and outcomes. Thirdly, due to the above, NGOs consequently generally fell into financial instability.

The great expectations that the Structural Funds initially gave rise to, have been followed by a large disappointment resulting from the system of project implementation and financial monitoring set by the managing authorities at the ministry level. The large amount of paperwork and changing rules in procedures led to long-term capacity strain. Instead of dealing with the content, NGO experts were faced with managerial and financial tasks.

The capacity was used inefficiently, mainly because of being understaffed in accounting, financial and project management. Human resources that had previously sufficed

in dealing with a project's administrative tasks, were suddenly insufficiently due to a number of reasons; the system of project reporting, financial monitoring and financing was set up improperly, with constantly changing rules and misleading information for the final beneficiaries. As a large number of projects implemented by the NGOs were within the EQUAL Initiative, we have looked at the Final Report of the National Implementation Structure for EQUAL 2005-08 (Fond sociálneho rozvoja, 2009).

In chapter 6 the report describes major malfunctions in the implementation and monitoring processes on both sides – final beneficiaries and the managing authority. Among many, we have identified those that are relevant for the ability of the NGOs to implement projects and illustrate the aforementioned. These are as follows:

- guidelines for project implementation and closure were issued ex post; not ex ante and in many cases very inflexibly
- required procedures for ESF programmes were not similar, which caused difficulties for the final beneficiaries dealing with projects in various programmes
- a lack of strict guidelines on the eligibility of costs within a managing authority led to incompetent and inconsistent decisions
- the inflexible system of financial flows had a negative impact on project implementation, mainly present in a delay of payments, leading to project management difficulties with contracting, deadlines, etc.
- insufficient indicators

On the side of the managing authority, two crucial findings regarding the NGOs performance were found:

- insufficient capacity of the personnel responsible for implementing projects, not performing all administrative tasks in a proper way
- final beneficiaries not following the guidelines, resulting in prolonging financial flows

From the above, we can understand the complexity of the processes and of identifying the real insufficiencies by the managing authority.

In many cases, the NGOs carried a burden of financing project activities without receiving sufficient refunds in proper time, thus resulting in cash flow shortage, spending of reserves and rising debts. The system of project monitoring in Slovakia in 2004-2006 brought forth enormous transaction costs mainly due to the unprecedented paperwork required by the managing authorities. As a result, NGOs often had to hire extra staff in addition to the in-house staff that was refunded from the projects, which again increased the overall costs for the said organizations. Financial monitoring, together with the existing refunding scheme, created a vicious circle for many organizations with delayed and postponed payments. The system of payments was based on a refunding mechanism, where the NGOs received money only after approval of the costs that had been incurred. The managing authorities, together with the Financial Authority, were not willing to use the prefunding scheme due to the fear of a large number of ineligible costs. Concurrently, the NGOs were required to provide 5 % of co-financing for the project. Even though the financial reserves and capacities of organizations were usually scarce, the

5 % co-financing rule was not seen as a burden, on the contrary; it was merely perceived as a useful tool for the prevention of a project-for-project scenario.

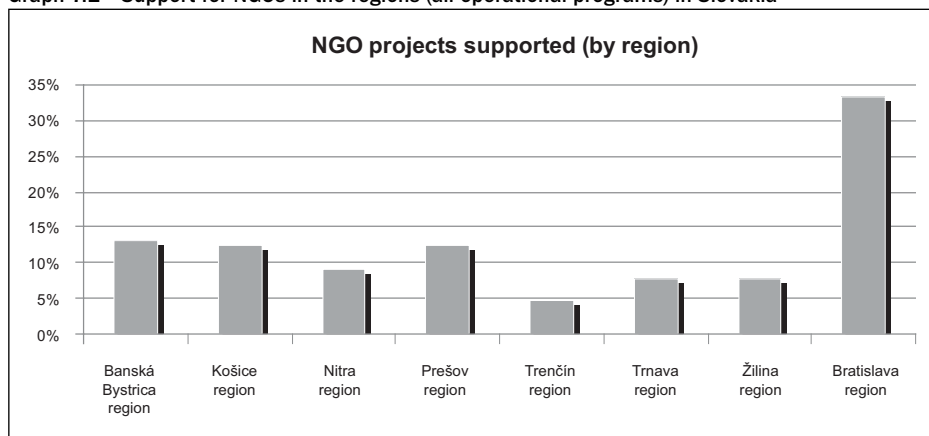
Based on the aforementioned, we can conclude that the mechanism of implementing EU Structural Funds in Slovakia during the 2004-2006 period was not designed properly with regard to NGOs. Many NGOs, which were involved in the process, were facing serious problems in the area of project pre-financing, human resources, project management and administrative compliance. This led to financial instability, staff fluctuation and a refusal of future involvement in EU Structural Funds projects. At the same time, funding through EU Structural Funds for the third sector led to two crucial outcomes for its capacity. Firstly, the great expectations from EU funds postponed the funding diversification process in many organizations. Secondly, both the state and the NGOs resigned from creating a sustainable model of financing or the introduction of new tools.

Table 7.6 Participation of NGOs spending in operational programmes in period 2004-2006 (in SKK)

Allocation of the Structural Funds and National Budget 2004-2006 (in SKK)			
Operational program	Total	NGOs	Share of NGOs
OP Basic Infrastructure	21,064,864,026	169,740,241	0.81 %
SOP Human Resources	13,953,754,242	191,409,407	1.37 %
SOP Industry and Services	8,962,934,737	-	0 %
SOP Agriculture and Rural Development	9,727,704,626		0 %
JPD Bratislava Objective 2	2,845,066,240	-	0 %
JPD Bratislava Objective 3	2,774,253,256	228,387,305	8.23 %
Interreg HU-SR-UA	458,953,384	60,033,542	13.08 %
Interreg AT-SR	387,561,476	89,907,392	23.20 %
Interreg SR-CR	224,652,682	11,292,792	5.03 %
Interreg PL-SR	457,266,654		
Equal	1,214,000,174	1,097,141,428	90.37 %

Source: author

There were no major differences among the seven regions eligible under Objective 1 in regard to the number of projects implemented by the NGOs. As shown in Graph 7.2 the NGOs in the Bratislava region participated in project implementation on a larger scale. However, with limited possibilities of funding for other areas and beneficiaries in the Bratislava region, it is not possible to make any comparisons based on this data. Most of the projects implemented by the NGOs in all the regions were supported by the ESF through two programs, the SOP Human Resources and EQUAL. Table 7.7 shows the number of projects in both programmes, based on region as well as the total number of NGO projects supported.

Graph 7.2 Support for NGOs in the regions (all operational programs) in Slovakia


Source: Author

Table 7.7 Support to ESF programs in 2004-06

Region	SOP Human Resources	EQUAL
Banská Bystrica region	23	11
Košice region	18	10
Nitra region	12	7
Prešov region	20	12
Trenčín region	7	4
Trnava region	5	7
Žilina region	11	6
Bratislava region	14	33
Total	110	90

Source: author based on the Equal Annual Reports

For a better understanding of the NGOs' role in the implementation of EQUAL we have chosen the year 2005 as a reference year and divided support to the NGOs by the measures. Table 7.8 shows that in the majority of the selected measures the NGOs played a crucial role in the implementation of projects.

Table 7.8 Support for NGOs within EQUAL measures

Measure	Nr. of approved projects		Approved resources (mil. SKK)	
	total	NGOs	total	NGOs
1.1. Creating a system supporting the introduction of long-term unemployed, low-skilled and other disadvantaged groups into the labour market	23	14	261.7	201.0

Measure	Nr. of approved projects		Approved resources (mil. SKK)	
	total	NGOs	total	NGOs
1.2 Creating an environment supporting the development and creation of effective solutions combating all forms of labour market-related discrimination, racism and xenophobia	14	10	170.1	140.1
2.1. Strengthening the capacity of NGOs and other social economy organisations as actors to help eliminate inequalities in the labour market (especially social economy organisations providing community service)	25	23	314.9	302.4
3.1 Support the creation of an environment stimulating human resources development and providing their adaptability in the process of structural changes and the coming of new technologies	22	10	268.3	144.2
4.1 Gender awareness-raising activities – gender studies, gender audit, gender awareness as the means for labour market equality between men and women	14	8	153.3	117.5
5.1 Supporting the social and vocational integration of asylum seekers	3	2	34.0	24.9
Total	101	68	1202.0	930.2

Source: author based on the Equal Annual Reports

7.4 Building Managerial Capacity

Through the European Social Fund considerable attention was paid to the personnel management of the staff of NGOs, particularly in the social field. More NGOs have begun to address the development of their employees and long-term work with them through public expenditure programmes.

The Structural Funds offer Polish NGOs a new source of funding to encourage them to undergo organizational changes and professionalize. They are thus able to create and submit appropriate projects (Dabrowski, 2008, p. 244).

Employees in non-profit organizations usually hold several roles, but they receive lower wages than in other organizations. NGOs are largely dependent on voluntary work provided partly by the employees, and partly by the public.

For example, 65 % of NGOs in Poland have no permanent staff (Gasior-Niemiec and Gliński, 2007). Employment in the non-profit sector, however, is increasing, but the NGOs still lack experienced and capable managers.

Box 7.1: NGOs capacity building in Slovakia

Pre-accession Funds together with Structural Funds formed the backbone for capacity building of the NGOs in Slovakia in the last decade. But was it really so? Did they have a real impact on their capacity building?

There is no relevant research or study explaining this fact in detail. We have tried to conclude in this matter based on the existing numbers as well as interviews with the relevant stakeholders. When we look at the areas of support from both types of funds, we see no specific focus on capacity building in the sector.

Within the pre-accession funds many projects contributed to capacity building in the organizations through their activities and implementation (such as financial management). After 2004 only EQUAL directly supported NGO capacity building. In measure 2.1. *Strengthening the capacity of NGOs and other social economy organisations as actors to help eliminate inequalities in the labour market, the focus was clearly on social economy organisations providing community service. "Previous experience confirms the NGOs and other social economy organisations are effective, far more flexible and available, compensating for the weaknesses of public and private service delivery. It is the reason to support these organisations – capacity building (premises, personnel, finance, skills, partnerships, support structures etc.)"* (MPSVR SR, 2005, p. 51). As Table 7.8 shows, almost one third of the resources in EQUAL implemented by the NGOs were used for this measure.

The SOP Human Resources includes measures on human capital enhancement with a clear focus on the labour market. Therefore, this program does not directly contribute to NGO capacity building.

The USAID Reports on the NGOs Sustainability Index from the years 2004 and 2006 include chapters on the capacity of NGOs. It has witnessed a declining demand for broad based trainings from the NGOs, but an increase in the demand for tailored trainings. Based on their findings there was an increase in the mission-focused development in the area of human resources, mainly with the larger NGOs.

In the 2004 Report USAID claimed that *"Slovak NGOs are still chronically understaffed because of a lack of funds to pay full-time employees. Many of those who work for NGOs are volunteers or part-time employees. The majority of NGOs employ independent contractors, relieving them of the responsibility of providing social security payments, health insurance, and taxes. There is a need for skilled staff, especially fundraisers and PR managers."* (USAID, 2005)

In addition to the above, the 2006 Report states that *"In 2006, there was a decrease in activities of NGOs focused on institutional development. After the withdrawal of large international donors focused on supporting institutional development and increasing the level of professionalism among their grantees, current donors – mostly companies giving through the 2 % mechanism – tend not to focus on capacity building but rather on implementation of specific projects."* (USAID, 2007).

These findings also show that the third sector has no sufficient funding for its capacity building especially in the areas necessary for further development (PR, fundraising). EU Structural Funds appeared to be one of the possible funding resources for capacity building. The new operational programmes for the 2007-2013 financial period, which were designed from 2005, included some measures dealing with this issue. In particular the Operational Programme Employment and Social Inclusion introduced a measure that was elaborated in partnership with NGOs and focused on the capacity building of the third sector organization. Among others, the main activities were workshops, trainings, internships, study visits and networking. The first draft of the National Strategic Reference Framework 2007-2013 included the measure and additionally proposed to implement it through an intermediate body that would be a third sector entity (Uznesenie vlády SR č. 832/C.4., 2005). Unfortunately, the new government of Robert Fico, which came to power in summer 2006, redrafted the measure and shifted the focus more on the public institutions responsible for project selection at the Ministry of Labour and Social Affairs.

7.4.1 Professionalization

The rate of professionalization of the Czech NGOs is still at a low level. There are approximately 50-100 fully professionalized non-profit organizations in the Czech Republic. These organizations operate on multiple source financing and are led by strong management (RVNNO, 2008, p. 35). This number is still very small. These organizations can be a model for other non-profit organizations and they can transfer them their experience.

There are several large and professionalized organizations in Poland too. These can pass their experience to those less experienced, but here there is little solidarity among NGOs themselves (USAID, 2008, p. 178).

There is a large difference among the level of professionalization of non-profit organizations. The differences are also caused by the specialization of particular NGOs. NGOs working in the field of social services have mostly professional staff. It is primarily due to the need to employ specialized workers. Their activities are also encouraged by the state and other public institutions.

Other organizations active in other areas of specialization (such as environmentally oriented or locally active organizations) are still at an amateur and voluntary basis in the Czech Republic (Partnership Foundation, 2009, p. 7-12).

The professionalization of NGOs in Poland differs according to the size of the city where the organization is located. There are several large and financially stable organizations on a professional basis in big cities. Only these large professionalized organizations were able to get funding from the Structural Funds. Thus, those organizations realize an increasing number of better financed activities. Their situation increasingly differs from organizations active in rural areas, which are virtually fighting for their very existence (USAID, 2008, p. 178). Gasior-Niemiec and Gliński (2007) called this process the oligarchization of the third sector in Poland.

There also appears to be a problem that large organizations can drag away the experienced staff of smaller NGOs. The staff can get higher salaries thanks to the implementation of the Structural Funds projects. It further deepened the differences among these organizations (USAID, 2008, p. 180).

Structural Funds allow the supported NGOs to employ permanent staff or to expand skills of existing staff. Thereby these funds promote NGOs' professionalism. Thanks to the Structural Funds various trainings and seminars for NGO staff can also be organized. Those seminars financed by the European Social Fund are for free and enable further professionalization. It leads to a large number of training centres for the Civil Society organizations in Poland being set up. Their quality varies. The availability of those trainings for small rural NGOs is insufficient and the bigger NGOs prefer paying private consultancy firms (USAID, 2008, p. 183).

According to a research study carried out by Janouskova, Skarabelova and Vesely (2008, p. 7), the organizations supported hire staff to manage the projects and new administrative staff to cope with the increased bureaucracy associated with the implementation of projects from European funds.

The study also indicates that: *"... funding for projects of nongovernmental organizations from European Union funds has a significant impact on the organizational structure and overall operations of the organization. Whether it is a manifestation of professionalization or bureaucratization would be subject to further discussions."* (Janouskova, Skarabelova and Vesely, 2008, p. 7)

Polish NGOs have difficulties in hiring new workers because of lower wages in the non-profit sector. Only large European projects offering relatively attractive salaries allow them to hire these workers. Usually the staff is hired just for the duration of the project (USAID, 2009, p. 181). The question is the sustainability of these newly created jobs.

Many of the newly created positions disappear after completion of the project financed by the Structural Funds, because the NGOs are no longer able to ensure their funding. The organizations lose the skills and knowledge of those workers, who leave. The same situation applies to the Czech Republic (Partnership Foundation, 2009, p. 14).

7.4.2 Global Grants

In Poland, the Structural Funds were mainly intended for large national projects in the first programming period 2004-2006. The average costs of projects were approximately 927 000 EUR. Only the large and financially strong organizations were able to realize those projects (Churski, 2008, p. 601). The Structural Funds also focus on small organizations in the new programming period 2007-2013 (USAID, 2009, p. 180).

Although building long-term capacity of NGOs is a goal of both the Structural Funds and the National Civil Fund, there is no other programme focused on it in Hungary (USAID, 2008, p. 116). The last actual attempt to build NGOs' capacities was the Trust Programme, which was closed in 2006/07.

In the Czech Republic the situation differs thanks to global grants. The Czech Republic was the only new member state with negotiated global grants intended to strengthen the capacities of NGOs in the social field (only NGOs in the social field). The Czech Republic managed to have two global grants in the Operational Programme Human Resources Development (OP HRD) and the Single Programming Document for Objective 3 NUTS II region of Prague (SPD3) in the previous programming period. The global grant was allocated one percent of the total programme allocation, and therefore served as an adjunct to the main areas of support. It is also noteworthy that both global grants were administered by a non-profit, private entity, the Civil Society Development Foundation (NROS).

Global Grants are a tool devoted exclusively to small non-profit organizations and allow them to absorb the Structural Funds. Thus, small NGOs had an opportunity to get EU funding. The Czech Republic implemented a number of programs which were designed to strengthen the capacity of NGOs in both the previous and in the current programming period. The projects approved under those global grants were very effective. The small NGOs wouldn't be able to submit and implement projects under the standard programmes.

The global grants allow a smaller allocation of the Structural Funds to individual projects. It enables more applicants/beneficiaries to be supported. Although the management of global grants is less demanding concerning the administration of projects, small NGOs can try to make sense of the administration of European funds on these small grants and to strengthen its administrative and technical capacity. The strengthened organization can then apply for funding from the Structural Funds in the subsequent calls for proposals.

The small organizations supported in the field of social inclusion can then play an important role in meeting the objectives of the programme, because they work with the most excluded people (GLE, 2007, p. 15). The experience of other Member States using the global grants show that this tool is not only helpful in increasing the capacity of the NGOs supported, but it also increases the self-confidence of small NGOs in submitting projects and administering European funds. It also increases the number of employees, provides services and improves the quality of new organizations when starting their activities (GLE, 2007, p. 69).

Grants are aimed at strengthening the capacities associated with the long-term sustainability of smaller or newly emerging NGOs in order to expand their social services to the needs of people at risk of social exclusion and the requirements of individual regions.

7.4.3 Project Preparation and Management

It is evident, that it is not a problem for Czech NGOs to prepare interesting and innovative projects suitable for the Structural Funds. The formal procedures of implementing such projects cause problems for NGOs (Kundrata et al, 2007, p. 115). It is evident

above all in the case of investment projects, which are the most demanding. NGOs do not have sufficient resources, neither financial nor personnel, to prepare the application and implementation.

In addition the subsequent financial management of the projects causes higher rates of problems in the case of NGOs than other beneficiaries (Soukupova In: Kundrata et al, 2007, p. 38). Non-profit organizations can not afford to spend funds on external advisory services. Even if it would help them in developing better applications. Therefore the NGOs have to rely mostly on its own staff and its skills. It may be a disadvantage for them in comparison with other entities competing with them for assistance from the Structural Funds. The other organizations generally use consulting services. For NGOs without previous experience with the management of funds from the EU, it can be very difficult to develop good applications. If an NGO intends to submit an application for a grant, it must consider the relatively high administrative burden of this process. Moreover, the applicant has no assurance that the appraisal committee will chose its projects to receive a subsidy.

Thus, many small NGOs in particular, carefully consider whether to invest their already scarce resources to develop applications for which there is no certainty that it will be approved. It appears that the most demanding and the most complicated projects of NGOs are those implemented as first (Janoušková, Skarabelova and Vesely, 2008, p. 5).

If the organization applies repeatedly for the assistance of Structural Funds, it can benefit from the experience gained from previous project management and project preparation.

As a good example, there is a case of the system operating in the Vysocina Region of the Czech Republic in the previous programming period. The financial support for preparing project documentation was provided by the regional office of the Vysocina Region. It was enough for the project to pass the assessment of formal requisites. This possibility was used by many NGOs and other bodies (Holy In: Kundrata et al., 2007, p. 113).

The bureaucracy associated with the administration and management of the project is a very problematic area from the perspective of NGOs. Most NGOs have not been ready to devote such a big share of the budget and activities to bureaucratic management. This has changed with the receipt of funds from EU Structural Funds. The management of projects financed from the Structural Funds is generally considered to be very burdensome.

A survey of the Czech NGOs assisted by the Structural Funds, mostly from South Moravia, showed that the activities associated with the administration of a project, on average, occupy 30 % of the time spent on the project. The remaining 70 % of time is devoted to project activities (Janoušková, Škarabelová and Veselý, 2008, p. 6). The situation is also similar for the case of NGOs in Poland (Dabrowski, 2008, p. 235).

It often appears that smaller NGOs misjudge their capacity. They often realize it during the course of the project. In particular, human resources, and time spent on project administration are the issues that are poorly planned (Kaspar In: Kundrata et al., 2007, p. 35).

Small Hungarian NGOs received grants, although they weren't prepared for it. These organizations did not have enough funds to hire additional administrative staff. If the

staff was hired, the organizations had to make considerable efforts to ensure their wages. It diverted those NGOs from their missions (USAID, 2008, p. 116).

Poorly estimating the intensity of administering the funds caused problems for a number of NGOs. Those difficulties could lead to delays in payment requests from NGOs and the subsequent financial problems (Horacek In: Kundrata et al., 2007, p. 50).

7.5 Conclusions

The civil society organizations in the Visegrad countries witness similar problems with the Structural Funds. We can conclude that NGOs have not built sufficient capacities to use the funds available or that just a few of those organizations were able to do so. The reasons for this are manifold: Since the NGOs have no real financial tool for their capacity building, and as a result capacities are mostly being built on the learning-by-doing principle. Based on our interviews with representatives of the third sector, this has proven to be rather inefficient. People who should deal with project activities on the content side are forced to cover other project tasks such as overall management or accounting.

The 2 % income tax assignment, however, initially improved the NGOs capacity in Slovakia. It was in their PR activities as it has required a more enhanced communication strategy in order to attract attention to the NGOs work. This tool, on the one hand, cannot replace core funding and cover the costs of professional staff. In the end the additional schemes implemented, as were the pre-accession funds, proved not to be a sufficient tool for NGO capacity building, neither for the NGOs financing. Its limited scope, together with an information asymmetry, caused this tool to be perceived as too vague and therefore inaccessible by many NGOs.

Conversely, the EU Structural funds have played an important role in changing the NGOs financing structure. But while many NGOs viewed the funds as a welcome magic wand, they have in time gradually become too dependent on this source of funding. Together with inflexible management of the programmes on the part of the state, this has led to a rapid spin of cash flow problems, financial difficulties and debts. Understandably, without being able to provide sustainable and regular funding for their core activities, the NGOs are do not succeed in attracting professionals and are facing serious staff turnovers.

Consequently, none of the tools as mentioned above have provided adequate resources for capacity building in the third sector. Against this background, the new EU financial perspectives 2014-2020, together with the expected rise in private donors, mean therefore two key possibilities for a change towards a more stable funding milieu and thus offering NGOs the needed prospects for their respective tasks.

Annex 7.1 Pre-accession funds in Slovakia from 1995 to 2005 (in thousands EUR)

Programme/ Subprogramme	Year													In total (in thousands EUR)
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	
PHARE - Cross-border cooperation	x	x	6 000	2 000	x	5 000	8 000	12 000	12 000	12 000		12 000		69 000
PHARE - ACCESS	x	x	x	x	x	x	x	900	x	x	x	x	x	900
PHARE ACCESS - Networking Facility	x	x	x	x	x	x	x	70		x	x	x	x	70
PHARE - Small Projects	x	x	x	x	x	1 050	1 300	1 374	1 200	1 200		1 200		7 324
PHARE - Regional environmental project	x	x	x	x	x	2 000	1 100	900		3 750		2 600		10 350
PHARE - Civil Society Development Programme	x	x	x	x	3 000			2 500		x	x	x	x	5 500
PHARE - Development of National Minorities Programme	x	x	x	x	x	x	619	2 810	10 000	1 000		2 250		16 679
Programme SOCRATES	x	x	x	x	x	x	x	1 456.7	1 409	x	x	x	x	2 865.7
Programme LEONARDO DA VINCI	x	x	x	x	x	x	x	1 430.8	1 261	x	x	x	x	2 691.8
SAPARD - Rural Development Program	x	x	x	x	x	x	x	18 000	19 000	19 000	x	x	x	56 000
Programme YOUTH	x	x	x	x	x	x	x	926.8	730	x	x	x	x	1 656.8
Programme CULTURE 2000	x	x	x	x	x	x	x	x	157	x	x	x	x	157
Pilot Grant Scheme for Tourism Development	x	x	x	x	x	x	x	x	x	3 500		3 500		7 000

Source: authors



CONCLUSIONS

Were there any changes made by the Structural Funds in Central Europe? That was the main question for this publication. We have not followed a quantitative approach in the publication, although it would enable us to show an exact measure. We have used qualitative methods of research. Instead we focused on the changes that are observable in the societies in question after the EU enlargement in 2004.

Certain changes can be seen, though not verified by econometric methods. We could say that there are some changes, although these changes may happen slowly because of the inertia of all the stakeholders.

If the resources from EU Cohesion Policy are used by the appropriate means, they can bring many positive effects. However, those positive effects are limited by several aspects. These aspects include the weak personnel and financial capacities of the final beneficiaries in the Visegrad countries. The limitation is also caused by stakeholders' unwillingness to plan and act in a strategic way. The effects of the EU Cohesion Policy also affected the understanding of absorption capacity as well as the spending of the allocated funds without achieving the actual effects. This issue, however, not only concerns the Visegrad countries, but the whole EU.

EU competitiveness in the global World can be supported through public aid. It must be done very carefully otherwise the Structural Funds can harm the ability of firms and the economy to be competitive, thus achieving the opposite to the desired situation. The chapter on innovation in SMEs in Saxony and the chapter devoted to cooperation between Czech and Polish entrepreneurs have shown possible ways. On the other hand, the results and effects of public assistance must be monitored to avoid a situation in which the assistance becomes counterproductive. Such a situation is described in the case of some of the activities in the Slovak Republic. Innovation must have an impact on the market and should not be just a copy of the situation already experienced and used by someone else. Such an approach can only improve the situation in the short-term.

Generally, we can see discussions about achieving development through EU funds. Some factors, such as dead weight loss, the limited financial capacity of the final beneficiaries and often the complexity of the support system play an important role. Responsibility for the use of the EU Cohesion Policy assistance is often a limiting factor for innovative projects and the willingness of beneficiaries to try new ways to come up with solutions and innovative practices.

The current setting of the implementation systems (both beneficiaries and implementing agencies) leads to many inefficiencies and deadweight loss. From this perspective it would therefore be appropriate to increase the responsibility of the beneficiaries and implementing agencies. From this perspective Barca (2009) mentioned this as performance-based contracts. It does not necessarily cause improvement if not accompanied by other steps. The expected increases in the efficiency of the assistance would not come about until the introduction of compulsory co-financing projects in all cases, including

the non-profit sector. It would put pressure on the beneficiaries to increase efficiency and only realize reasonable projects. If this pressure is coming from below, from the project level, it is difficult to expect that this pressure will be applied by the implementing agencies.

Many countries have experience with contracting the public sector's agencies as intermediary bodies in the countries of Central Europe. There, the financing of those bodies is based on negotiation with politicians, not on the outputs sold on the market. An increase of efficiency can be achieved by a simple step – by introducing a requirement for the managing authorities to choose intermediary bodies in the process of public tendering. This would lead to an increase of efficiency, even if the real situation can show that there is only one candidate. The potential threat of competition can help to increase efficiency in itself. It is great deal for politicians to take such a step.

There is the question as to whether 100 % financial cover by the EU Structural Funds is an appropriate in some countries. Such an approach leads to a comfortable life for some of the final beneficiaries. The situation might be improved by introducing a co-financing requirement.

Many of the countries have been using some type of such contractual relations. To undertake such tasks, all sectors have to improve absorption capacity and capability with the assistance of structural interventions. However, easier access and reasonable administration requirements are needed to speed up this process. One of them is to base the Structural Funds assistance on results-based contracts with the final beneficiaries. If the results are achieved, then the payment can be made. Without achieving the promised results, there will be no, or lower payment. It would increase the importance of the project-proposals appraisal process on one side, and it would probably significantly reduce the bureaucratic burden on the other side.

Almost all chapters came across the problem of bureaucratic burden. It should be simpler and faster for all final beneficiaries to access the resources. The final beneficiaries complained about the excessively high administrative burden of preparing and implementing projects assisted by the Structural Funds in the countries surveyed. They also complained about their financial capacity and the inability to implement projects due to the necessity of co-financing the projects or cash-flow problems in many cases. This situation is typical not only for non-profit organizations, but also for other types of final beneficiaries.

The improved implementation of the EU Cohesion Policy can be done not only from the project level, but also from the programme level. One way of achieving this improvement is to use the results of evaluations and their recommendations. Although the vast number of evaluation studies were realized, it is apparent that any improvement in the situation is a slow process. This situation is caused by evaluations not being used for the purpose for which they should be used.

We see that most countries facing the impact of the global financial crisis and EU internal problems seek tools to reduce public expenditures. The use of evaluations is one of the most convenient tools, although not universal.

This is a small contribution by the authors of this publication to the discussion about the future of the EU Cohesion Policy for the period 2014-2020. The European Union will face a number of problems and challenges during this period. An effective implementation system of the EU Cohesion policy could significantly contribute to solving these problems. On the other hand, a poor implementation system may worsen the problems. Therefore, it makes the current debate on the future of the EU Cohesion Policy highly important.



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Since its adoption in the 1980s the EU Cohesion Policy has proved to be one of the most vigorous EU policies. The Eastern Enlargement of the European Union in 2004 was a historical turning point not only for the New Member States, but for the European Union as well. Thenceforth Cohesion Funds for the most part have flown to Central and Eastern Europe.

This publication analyses the impacts and changes that the EU cohesion policy brought to the countries in Central Europe. The first part of the book concerns the Structural Funds' assistance to enterprises. The second part focuses on the impact the Structural Funds have had on the civil society.

The articles of the collected volume discuss the pros and cons of the European Cohesion Policy in the Central European countries. There is no doubt that the resources of the Cohesion Funds, when used by the appropriate means, engendered many positive effects. However, there are also some aspects that limit the positive effects. Therefore an improvement of the Cohesion Funds Programme is necessary, a task to be solved within the negotiations for the programming period 2014-2020. This publication is a contribution to the ongoing discussion.

