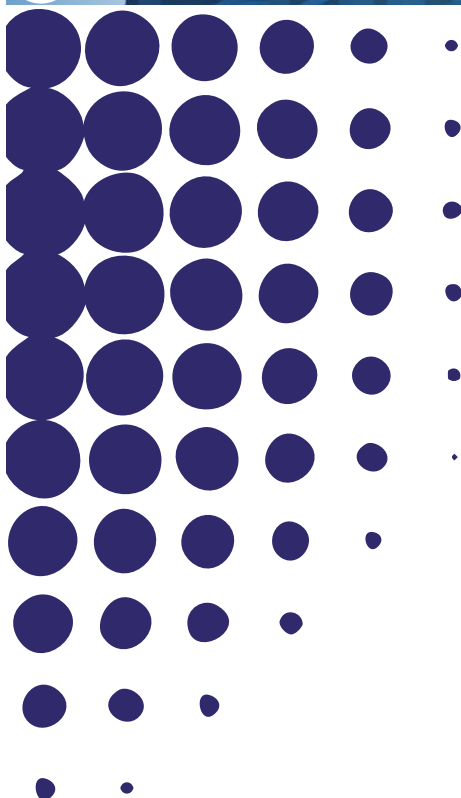


D5.3 SEARCH DERIVERABLE

Report on policy implications on legal and political framework conditions in the European neighbourhood area.

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Deliverable 5.3. Report on policy implications on legal and political framework conditions in the European neighbourhood area¹

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1. Introduction

The SEARCH project is aimed at analysing the impact of the European Neighbouring Policy (ENP) on the integration of the neighbouring countries with the EU with respect to several areas, such as trade flows, people mobility, human capital, technological activities, innovation diffusion and institutional environment.

¹ The research summarised here has been produced by the following authors (in alphabetical order): Semih Akcomak, Will Bartlett, Maurizio Borghi, Lubov Cherkasova, Nevenka Cuckovic, Cansu Durukan, Erkan Erdil, Asli Ertan, Marcella Favale, Lusine Grigoryan, Guy Harpaz, Nikolaos Hlepas, Kresimir Jurlin, Anneli Kaasa, Nadezhda Lebedeva, Hanna Muller-Zick, Aleksandra Nojkovic, Ekaterina Osipova, Muge Ozman, Eve Parts, Teoman Pamukcu, Fabrice Periac, Ana Popa, Vesna Popovski, Javier Revilla Diez, Daniel Schiller, Peter Schmidt, Alexander Tatarko, Serdar Turkeli, Ugur Yalciner, Daria Zvirgzde.

A relevant area of research within the SEARCH project is related to the contextual framework where most social and economic interactions occur (Work Package 5 – WP5). In other words, the institutional, social and cultural environment of European Neighbourhood Policy (ENP) countries constitutes the focus of the present deliverable.

The current status of the social, cultural and institutional environment in the ENP area, the identification of the impact of current changes and transformations on the prospects for improved economic development, social cohesion, and stronger integration with the European Union (EU) and, in particular, with European New Member States (NMS), represent elements of crucial importance to design policy interventions in all social and economic respects.

Within WP5 researchers highlight that in order to attain cohesion among cores and peripheries as well as sustained process of economic development, good-quality institutional arrangements are fundamentally needed. These should ensure an efficient long-term upgrading of capabilities, functions, and networks at various levels.

Although WP5 generally deals with the institutional environment of the ENP region, its content is extremely heterogeneous, covering a wide range of aspects linked to the large notion of institutions. Aspects of formal and informal institutions in ENP countries are addressed by researchers as well as elements linked to culture business environment, social cohesion and inclusion. The essential role of good quality institutions has been recognized by academics and policy makers. Since the pioneering contributions of North (1990), the role of institutions in shaping development trajectories and growth has received large attention. Furthermore, a large debate has focused on the differences and complementarities of separate aspects of the institutional environment, which refer to a formal and to an informal dimension of the institutional context of countries and regions. In this respect, it has been argued that the concurrent existence of adequate formal (societal) and informal (communitarian) institutions that can spur national and regional collective action as well as encourage coordination among social and economic actors is fundamental to provide national and local economies with an environment that is favourable and prone to economic development (Rodríguez-Pose and Storper, 2006).

A last consideration on the role and importance of the institutional environment regards the position of WP5 with respect to other WPs in the SEARCH project: the success and failure of economic exchanges and flows, development strategies and policy measures for growth will be probably highly dependent upon the quality of institutional interactions among economic and social actors within an economy and on the set of incentives that the institutional context will provide them.

This report is aimed at specifically taking into account the **role of institutional, social and cultural factors** in shaping ENP countries' development trajectories. In particular, it summarizes the state of the results from the 26 working papers grouped into 7 research tasks.

The first research task focuses on the specificities of **social capital** in Central and Eastern European countries, both those already members of EU (NMS) and those who are included in the ENP framework (including the countries who might apply for membership in possible future enlargement rounds). Social capital constitutes one fundamental driver of innovation, economic development and, more generally, of activities which may lead to higher prosperity in Neighbouring Countries, such as inter-firm cooperation, and the formation of communities and networks of people. As a sum, the various working papers together give an empirical overview of the composition, levels, changes, determinants and outcomes of social capital comparatively in old EU members, new member states and neighbouring countries.

The second task is related to the role of **cultural diversity** on innovation and it is aimed at exploring the role of cultural diversity on innovation as an important factor of economic performance. All researchers used their own point of view and that enabled a manifold treatment of this topic. When cultural diversity is under consideration, it can be understood as the differences between different countries, but also as the cultural diversity within countries. Hence, at least two important questions have to be answered. The first question is about the impact of cultural background on innovation and which cultural characteristics are promoting innovation and economic performance and which are hindering. The second question is about the impact of cultural diversity, including ethnic fractionalisation, within a country (or region) on national performance and

economic success of a country. Even in globalization era, cultural and ethnic diversity has been implicated as a factor of poor economic performance. Beside of that, there are many other questions that need answering. For example, it is reasonable to assume that beside the direct impact of cultural background and diversity, these factors may also influence innovation performance via some mediators, for example social capital. Last, it can be assumed that the culture as the set of values of beliefs has its influence on the attitudes towards innovations that in turn, undoubtedly are related to actual innovation performance in a particular country.

With respect to the third task, this investigates the **quality of national institutional settings**, which is believed to play a major role in the economic success of countries. In other words, institutions shape the modalities according to which economic actors organise their economic life, produce, consume and invest. More precisely, “institutions are the rules of the game in a society or [...] the humanly devised constraints that shape human interaction” (North, 1990: 3). As such, understanding the link between institutions and the economy in the European Union as well as in European Neighbouring Countries (NCs) is of utmost importance for economic development and success. The European Union has recently experienced two Eastern enlargement rounds that have enriched the whole area with a variety of institutional backgrounds. Although New Member States (NMS) succeeded in being in line with the so called *acquis communautaire*, which fundamentally represents a set of political and legal principles that all EU member countries should embrace, they are still characterised by some institutional features that influence their economic development potential, especially in more deprived regions. The existence of an institutional differential appears even more pronounced considering NCs, that is those countries that are part of the European Neighbouring Policy (ENP). Institutional reform is fundamental in most of these countries for national economies to work and development process to be encouraged and sustained. The objective of this research task is exactly that of analysing and comparing the institutional features of EU countries and NCs in order to create both a static map of different institutional contexts, which affect differently national economic performance, and also a dynamic map of institutional change and evolution that may guide institutional reform in NCs towards European values and norms. Each researcher has addressed a particular aspect of

institutional quality exploring the topic from different perspectives. Thus, they individually provide interesting comparative studies of institutional quality and collectively offer a manifold view of institutional context that characterises EU countries and their bordering neighbours. Much variety in the treatment of the topic is also connected to the width of the notion of institutions. In this respect, the various contributions employ different concepts of institutions that reflect separate aspects of institutional quality, ranging from governance to the rule of law, from the level of corruption to regulatory quality etc. Therefore, while all studies develop a comparative analysis of institutional quality across countries, they focus on peculiar aspects of the notion of institutions. These different aspects, in turn, not only play specific roles in shaping national economic performance but they also interact among each other.

As far as the fourth research task is concerned, the focus is on **business culture**. In recent decades, economic growth and development have strongly benefitted from the presence of small and medium enterprises (SMEs). In both advanced and transition economies SMEs have covered a relevant role in job creation, innovative activities and practices and fostering competitiveness (Acs and Audretsch, 1994). For these reasons, the creation of a dynamic SMEs sector in ENP countries is considered as a crucial step towards the process of sustained development, economic regeneration and unemployment reduction. Therefore, policy instruments oriented towards the improvement of local business culture and entrepreneurship are extremely relevant in the ENP context. The objective of this task is that of analysing the quality of formal and informal institutional settings that influence SMEs development and performance in ENP countries. The task consists of two contributions focussing on different aspects of the topic. Overall, research provides an overview of the complex set of relationships that link the quality of local business culture in transition economies, the development of SMEs and their role in economic and innovative performance and the relevant role of foreign firms in facilitating SMEs formation.

The importance of an educated workforce has been highlighted in recent years by most scholars, policy makers and practitioners, and this is the topic of the fifth task. Attaining higher levels of education in the population and employing skilled labour represent

fundamental drivers of economic growth and unavoidable measures for any development strategy. For these reasons, it is essential to investigate the state of **educational systems** in the ENP region, since transition and emerging countries may strongly benefit from a more educated workforce. The objective the task is that of providing an outlook to the quality of education systems in the ENP area, with a focus on the relationship between available skills and labour market demand. In fact, there can be mismatches between supply and demand in the labour market that vanish investment in education. This risk is particularly high in the ENP region due to a number of frictions in the functioning of markets.

The sixth task focuses on the degree of social cohesion into local communities and the satisfaction with the institutions of **national and subnational governance**. These are key elements that influence people quality of life, economic performance, market transactions and, eventually, development trajectories. Overall, ENP countries are affected by low levels of trust of their citizens towards national and regional administrative structures of governance. This deteriorates social cohesion and inclusions, yielding negative effects on local economies as a whole. The objective of the task is to explore and analyse the state of quality of life and local governance in the ENP area, with specific reference to essential aspects such as social cohesion and trust towards national and local governments. Three papers contribute to this study and they focus on different but complementary elements of the discussion. Overall, this task aims at discussing the importance of aspects of institutions that regard the quality of local governance and people trust towards public authorities. In this respect, social inclusion and cohesion as well as improved quality of life are essential ingredients that increase the performance of actors involved in governance at both the national and the regional scale.

Finally, the seventh task is related to the **legal and regulatory framework**. A crucial issue in the implementation of the ENP is the need for institutional approximation and convergence in legislative and regulatory areas. In the context of WP5, a line of research has been identified in the analysis of the *institutional framework* for the mobility of tangible and – especially – intangible assets between the EU and the NCs. The experience of previous EU enlargements has provided evidence that harmonization in key areas of

law such as intellectual property and competition law deeply affects the investment climate in technology intensive sectors.² On the other hand, previous research³ demonstrates that the lack of convergence in the protection of intellectual property rights (IPRs) is the most prevalent and visible problem due to offshore manufacturing, especially in ‘patent-intensive’ industries such as ICT and pharmaceutical, and in ‘brand-intensive’ industries such as fashion and leisure goods.

It has since long been noticed that institutions matter for growth and technological upgrading. They provide the incentive structure against which individuals and firms are making their decisions. However, it has also been recognized that the proprietary regime over intangibles deeply affects the access to and availability of critical assets such as ICT infrastructures, educational resources and state-of-the art know how. Worries arise from the fact that, in the last decade, regulatory systems (and IPRs regimes in particular) have been imposed on less-favoured countries as non-negotiable sets of pre-conditions, and have been rarely the subject of shared policy decisions.⁴ From an institutional perspective, the transfer of regulatory frameworks (formal institutions) to other contexts is not an easy task since norms and other social practices (informal institutions) might be incompatible. Thus, the unilateral imposition of formal institutions is quite contrary to the principles that inspire the ENP.⁵ Although scholars agree on the negative impact of unilaterally imposed regulatory systems, there is still a lack of consensus as to the means of improving institutional approximation and convergence in international trade in intangibles.

² Commission Communication of 11 December 2002 on industrial policy in an enlarged Europe, Brussels, 11.12.2002, COM(2002) 714 final.

³ M. Borghi & M.L. Montagnani, *Models for managing intellectual property rights on the Internet. On-line distribution of digital media content*, October 2009. Report for the EC’s 7th Framework project COUNTER – Counterfeiting & Piracy Research.

⁴ See e.g. Amy Kapczynski, ‘Harmonization and Its Discontents: A Case Study of TRIPS Implementation in India’s Pharmaceutical Sector’, 97 *Cal. L. Rev.* 1571 (2009). Available at: <http://scholarship.law.berkeley.edu/californialawreview/vol97/iss6/2>; Jerome H. Reichman and Rochelle Cooper Dreyfuss, ‘Harmonization Without Consensus: Critical Reflections on Drafting a Substantive Patent Law Treaty’, *Duke Law Journal* 2007, 57.

⁵ A New Response to a Changing Neighbourhood A review of European Neighbourhood Policy, Joint Communication by the High Representative of The Union For Foreign Affairs And Security Policy and the European Commission, Brussels, 25/05/2011, COM(2011) 303

2. Policy aspects of research results

Considering the wide heterogeneity of topics discussed in the seven research tasks mentioned above, we report policy aspects for each task separately.

The working papers of the first task offer an empirical overview of the past and present state of social capital in Europe, distinguishing between old EU-members, new member states, and neighbouring countries. Additionally, these papers explore alternative determinants of social capital, such as socio-demographic factors, political and institutional factors, and ethnic value orientations. Also, the effect of social capital on individuals' monetary attitudes and nations' economic performance and competitiveness are analysed. Together these working papers draw a broad picture about the specific features of social capital in different country groups. What generally emerges is that social interactions might function as a positive element in economic dynamics, facilitating interactions and increasing cooperation. In this respect, trust appears as a crucial aspect of social capital.

As regards the second task, papers suggest that the degree of cohesiveness in a society has a positive sign on innovative activities. Therefore, measures should be aimed at reinforcing networks and links between different social and economic actors, such as firms and individuals. Moreover, it has to be taken into account that culture is a very broad phenomenon and different dimensions and aspects have to be considered when creating policies based on the knowledge about the impact of culture on innovations. More than one working paper concludes that care should be taken because in different countries different cultural dimensions may hinder innovation and every case (country, region) should be analysed separately. While cultural differences between countries/regions turned out to be significant and worth considering, the differences and diversity within countries or regions appeared not to be a problem, contrarily to the widely accepted assumption of the negative impact of cultural diversity and ethnic fractionalization. This is in accordance with the result that while the cohesiveness seems to be important for innovation, heterogeneity of links appeared not to be important.

Working papers in the third task offer a comparative view of national institutional environment in ENP countries. The comparison with EU countries, both old and new, suggests that the speed of the process of convergence of institutional quality towards European norms and values is still slow, although some progresses have been registered. Good institutional quality appears extremely important in the ENP area to encourage economic actors to get involved in economically productive activities and to trigger economic development. For this purpose, institutional change and reform is strongly needed.

As far as the fourth task is concerned, the research developed in WP5 offers a discussion on the role of institutions, local business culture and SMEs development in ENP countries. ENP countries are very heterogeneous entities and these papers do not explore all of them. However, a valuable picture of interesting case studies emerges from the discussion. Local entrepreneurship often suffers from strong institutional frictions and from a business environment that does not provide incentive to SMEs to invest and upgrade their activities. This has negative implications on innovation and employment. Foreign firms might play a crucial role in improving local business culture by establishing connections with domestic firms based on market links or cooperation. Importantly, national policy makers should consider the potential benefits stemming from measures that reinforce institutions and the correct functioning of markets in order to stimulate the SME sector as well as to attract foreign investment.

Research in the fifth task focuses on the capacity of educational systems in the ENP area to provide a skilled workforce that is matched with local labour demand. An inverted-U pattern of mismatch across education groups is identified. Particularly severe mismatch emerges among secondary educated people in transition countries, especially those who graduate from vocational schools where curricula are inadequate to the labour market needs and funding for equipment is relatively constrained. With respect to emerging markets, mismatch is higher among highly educated university graduates. There is also clear evidence of a gender bias in mismatch patterns. In terms of policy recommendations, public policy should be informed by labour market forecasts and analysis in order to restructure and reform educational and training systems in most ENP

countries. Policy measures could include incentives to old and low skilled workers to retrain and to firms to provide better in-house training, measures to improve the inclusion of women in the labour market, special tools to encourage firms to hire young workers, and stimulating spillovers from foreign firms to domestic companies through labour mobility.

As regards the sixth task, papers discuss the importance of aspects of institutions that regard the quality of local governance and people trust towards public authorities. In this respect, social inclusion and cohesion as well as improved quality of life are essential ingredients that increase the performance of actors involved in governance at both the national and the regional scale. Therefore, policy makers should formulate and adopt measures that reinforce governance structure and increase citizens' trust in institutions.

Finally, papers in the last task argue that the ENP's ambitious agenda, coupled with its ten years of operation, when examined in the light of its potential benefits, raised expectations for comprehensive alignment of legislation by the NCs with resultant significant socio-economic reforms. Yet the results of the ENP on the eve of its tenth anniversary are much less impressive and the initial high hopes for a comprehensive and systematic legislative and regulatory alignment have not been realized. Extensive scholarship, including that conducted by the SEARCH Consortium, indicates that such alignment is limited, partial, selective and uneven. In that respect the ENP, which was modelled on the institutional and procedural experience of the successful enlargement policy and which adopted the enlargement's ethos, instruments, procedural and institutional aspects, bears in fact more resemblance to the unsuccessful European Mediterranean Policy. Furthermore, with respect to Intellectual Property Rights (IPR), these vary greatly in European neighbouring countries. Some similarities can be detected within the policy sub-groups (Eastern European, Southern Mediterranean, and Black Sea countries), but this is not a general rule. Since barriers to trade can be produced not only by lack of implementation of IP norms but also by a dysfunctional infrastructure enforcing such rights, IPR assessment needs to be put in context. This mixed scenario on the general progress of the European Neighbourhood Policy corresponds to the picture displayed by the analysis of the detailed country reports. While on the one hand a general

progress can be detected in implementing IP legislation and in the signature (or at least advanced negotiation) of several international treaties and multilateral conventions, IPR infringement rates and piracy are not reported to be decreasing, if not marginally. In sum, while the adoption of the EU intellectual property framework appears as a leap forward in terms of IPR protection in neighbouring countries, this alone cannot lower the barriers to trade if it is not paralleled by substantial improvement in the social, legal and economic system of these countries.

In general, what emerges from research conducted in WP5, institutional, social and cultural factors are central elements to consider when analysing social and economic dynamics in ENP countries. Reinforcing these elements is crucially important to foster economic development and growth. Therefore, policy makers should set up measures that improve the institutional structures at the national and at the subnational level in ENP countries according to individual countries' specificities. However, policy makers should also bear in mind that influencing institutional outcomes, both in terms of formal and informal institutions, is not a straightforward and short-term process due to the path-dependency and resilience that characterise these social structures.



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