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Gergő Medve-Bálint & Vera Šćepanović

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EU funds, state capacity and the development of transnational industrial policies in Europe's Eastern periphery

Gergő Medve-Bálint[a,b] and Vera Šćepanović[c]

[a]Centre for Social Sciences, Hungarian Academy of Sciences, Budapest, Hungary; [b]Corvinus University of Budapest, Hungary; [c]Faculty for Humanities, History and International Studies, Leiden University, Leiden, Netherlands

ABSTRACT

Many have claimed that in the dependent market economies of Central and Eastern Europe industrial policy has been reduced to incentives to foreign investors – a feature accentuated by their loss of policy space through integration into the European single market. In this paper, we offer an alternative view by arguing that the European Union (EU) has in fact made it possible for its members to recover a degree of policy space lost to economic and regulatory integration. The EU does this through *transnational industrial policy*, which is the combination of its competition and cohesion policies. The former limits cross-country competition for capital; the latter provides additional resources to support a more inclusive industrial policy benefiting small and medium enterprises (SMEs). However, effective utilization of transnational industrial policy depends on domestic state capacities. We demonstrate this by comparing the distribution of EU funds to automotive firms in Poland and Romania. In Poland, efforts to create institutions that promote SMEs have resulted in a more balanced distribution of EU resources, while in Romania a weak and unstable institutional environment led to their greater concentration, thereby reducing European funds to another source of rents for the most powerful firms.

KEYWORDS

Dependent market economies; EU funds; transnational industrial policy; upgrading; automotive industry; Central and Eastern Europe

1. Introduction

Globalization brought a radical retreat of traditional industrial policy. Transnational regulatory integration has rendered its most prominent tools, such as manipulation of trade policy to capture investment and promote exports, and targeted support of domestic champions, either illegal or too costly. Development scholars described this as 'kicking away the ladder' (Chang, 2002) or 'shrinking policy space' (DiCaprio & Gallagher, 2006; Wade, 2003) and argued that it

CONTACT Gergő Medve-Bálint Medve-Balint.Gergo@tk.mta.hu Centre for Social Sciences, Hungarian Academy of Sciences, Tóth Kálmán utca 4, MTA TK, 1097 Budapest, Hungary.

prevented developing countries from nurturing successful manufacturing industries. Even those who stress that globalization has brought new opportunities for industrial growth through rising foreign investment and global production networks admit that joining the transnational value chains is not the same as building them (Baldwin 2011).

The latter insight forms the core argument of a burgeoning 'new dependencia' literature, which is concerned with the limits of foreign capital-led development. The strong version of the argument posits that reliance on foreign investment creates dependent market economies (DME), which are locked into a semi-peripheral position without credible perspectives for industrial upgrading (Nölke & Vliegenthart, 2009). This is because innovation and broad capacity-building in the host countries do not feature in the strategies of foreign companies which can always source their inputs and technologies elsewhere. While DMEs may develop successful FDI-based export sectors, these remain disconnected from domestic production and innovation systems, and the lack of industrial policy tools leaves host countries unable to push their economies ahead in the transnational value chains. Moreover, competition for foreign capital drains domestic resources from other industrial policy objectives such as support to small and medium enterprises (SMEs), which would facilitate a more broad-based integration into transnational production networks.

While we recognize that regulatory constraints and capital mobility significantly narrow the policy space for developing countries, we find the strong version of the 'new dependency' argument to be overly restrictive. Despite the common external constraints, developmental outcomes still vary, even among countries with ostensibly similar positions in the global production system. This suggests that some space for manoeuvre is still available to developing economies, and makes it all the more urgent to explore alternatives they can pursue to carve a better position for their firms in the world of global value chains.

In line with the overall argument of the Introduction to this Special Issue, we argue that variation in developmental outcomes is determined by how pressures of globalization are filtered by developing countries' own institutions, as well as by the institutions of the transnational integration regimes (TIRs) in which they are embedded (see Bruszt and Langbein, this issue). Globalization notwithstanding, transnational economic and regulatory integration largely take place within these regionally circumscribed blocks, and some of them, the European Union (EU) in particular, have gone especially far in curbing their members' ability to pursue autonomous economic policies (Hay, 2004; Jabko, 2006). Yet, it would be wrong to see TIRs merely as steamrollers of globalization, for they are also the primary sites for transnational institution- and policy-building: a way to 'manage' globalization (Jacoby & Meunier, 2010), and a potential source of new opportunities for domestic agency (Bruszt and Palestini, 2016). These opportunities come in the form of specific regulatory and financial tools that can be used to offset the negative consequences of economic integration.

Indeed, while the EU may be the most extreme example for how economic integration prevents countries from regulating their own markets, it also has the most advanced set of regulations and compensatory tools to alleviate some of the negative externalities of this process (Bruszt and Langbein, this issue). In other words, while preventing its member states and many associated countries from pursuing independent industrial policies that rely on protection and discriminatory promotion of domestic economic actors, the EU has accumulated a battery of resources and policy tools that amount to a novel form of *transnational industrial policy*.

In this paper, we explore the scope and limitations of this transnational industrial policy, by focusing on the use of the EU's policy tools in the Central and East European (CEE) member states. The CEEs are textbook examples of DMEs. Having entered the world economy in the full swing of transnational economic integration, they had to rebuild uncompetitive socialist-era industries without recourse to the recipes of the late twentieth century developmental states. Instead, they embarked on a foreign capital-led, 'hyper-integrationist' developmental trajectory which was both directly and indirectly encouraged by the EU (Medve-Bálint, 2014), and which rewarded them with rapid integration into global value chains (Šćepanović 2013), but at the price of becoming thoroughly dominated by foreign firms. Consequently, CEE exhibited most of the symptoms highlighted by the 'new dependency' literature: dearth of domestic firms in the export-oriented sectors, limited investment in technologically advanced activities, and excessive spending on incentives to foreign capital (Drahokoupil, 2009; Pavlínek, 2018).

To what extent can transnational industrial policy alleviate these negative effects of foreign-led development? In this paper, we show that certain EU policies could assist CEE states to evade the developmental trap envisioned by DME scholars: while EU state aid regulations prevent costly competition for capital, EU funds help to diversify industry and nurture SMEs. However, to successfully exploit these opportunities, the states must also possess a considerable degree of domestic capacity.

We study the interaction of transnational industrial policy and domestic capacities by analyzing public support to the automotive industry in two CEE states, Poland and Romania. Both countries are heavily dependent on foreign capital and have been subjected to 'deep' integration with the EU (Bruszt and Vukov, 2017), including harmonization with European state aid and competition policies. Both also received financial and technical assistance to implement these measures, as well as to better manage further EU financial support. However, Poland and Romania differ in their domestic state capacities, which allows us to explore the limits to the transnational industrial policy.

This is also the reason why we chose the automotive industry, which represents one of the prime examples of highly integrated transnational modes of production. Lead firms dictate much of what happens further down in the chain, including the degree to which they are open to access from smaller local firms (Gereffi, Humphrey, & Sturgeon, 2005; Humphrey & Memedovic, 2003). The industry has also long been among the primary targets of investment competition in CEE, and thus offers a critical case for testing the reaches of industrial policy, both domestic and transnational, in the age of global value chains.

The following section describes the two arms of the EU's transnational industrial policy: regulations to restrict competition for capital, and funds to support SMEs. Next, based on a unique dataset that combines company-level financial and ownership data with records of EU funding to private firms in the 2007–2013 programming period, we explore the degree to which the distribution of funds in the Polish and Romanian automotive industries complies with the objectives of transnational industrial policy. We find that Poland has been more successful at diversifying funding than Romania, where EU support is biased towards large firms. In Section 3, we trace this variation to different levels of state capacity, as reflected in the network of domestic public institutions supporting SMEs. The final section concludes and suggests further directions for inquiry.

2. The workings of transnational industrial policy in the EU's eastern periphery

The EU's transnational industrial policy comes in two guises. The first takes the form of 'beneficial constraints' (Bruszt, Munkácsi & Lundstedt, this issue), whereby the EU's state aid regulations prevent states from depleting their own budgets in the race to attract foreign investment. The EU specifies strict ceilings on all such subsidies, but these are set higher for backward regions in order to raise their attractiveness to investors. Second, the EU's cohesion policy provides additional funding to promote research and development, innovation, and upgrading of smaller firms in less developed areas. This assistance, which is distributed through operational programs (OP) designed jointly by the European Commission and national governments, is not limited to the provision of funding but is accompanied by a transfer of capabilities and ideas that guide the implementation of these funds.

While the debate on the costs and benefits of EU-imposed constraints on investment promotion is quite advanced, the contribution of cohesion policy to industrial policy is yet to be explored (but see Duman & Kureková, 2012). However, we argue that to understand the scope and limitations of the EU's transnational industrial policy, we need to investigate both dimensions.

The combination of EU funding and the state aid regime's beneficial constraints allows transnational industrial policy to remedy three interlocked problems: bolster the bargaining power of governments *vis-à-vis* large firms by 'tying their hands' with a binding framework for incentives; prevent harmful competition between states; and provide additional resources to promote horizontal policy goals. The resulting policy recalls the classical principle of 'embedded autonomy' (Evans 1995) – allowing governments to work closely with companies in pursuit of development, but without falling prey to rent-seeking by the most powerful private firms.

At the start of the EU integration process, CEE was in dire need of help on both fronts. The socialist legacy and the vagaries of transition have left these countries thoroughly dependent on external capital, and the competition for mobile foreign investments soon escalated (Drahokoupil, 2009). Foreign companies capitalized on this by staging 'beauty contests' between prospective hosts, driving up the value of incentives in a region that was already considered one of the most attractive locations for manufacturing investments in Europe. This is not only wasteful, as the countries overpay investments that would have probably taken place anyway, but could also drain domestic resources away from other policy goals. Indeed, smaller domestic enterprises were initially excluded from investment support, which was conditional on high capital thresholds. Other forms of assistance were sparse, and the underdeveloped local capital markets could not plug this gap, thereby limiting the SME's potential for growth (Volz, 2011).

The EU's transnational industrial policy created opportunities for CEE countries to tackle both problems. First, the state aid rules substantially contained investment competition. While the CEE states originally resisted imposition of state aid regulations for fear that it will undermine their ability to attract investment, they were well aware of the costs, and in the post-accession period they all exhibited a remarkable degree of compliance (Blauberger, 2009). However, while the EU rules eliminated excessive aid to individual investment projects, the total amount and composition of state aid did not change radically: the most powerful firms still win a lion's share of the subsidies and the automotive firms are often among them. In Romania, between 2007 and 2014, roughly half of 800 million EUR of state aid dedicated to investment promotion went to automotive firms (see Vukov, this issue). In Poland, between 2004 and 2013 the total value of automotive investments exceeded EUR 3.3 billion, and nearly 30% of these investments received state aid (PAIiIZ, 2014).

With domestic funds still primarily focused on attracting foreign capital, the EU cohesion policy became a significant resource for diversifying support to a broader range of recipients, in particular SMEs. EU funds represent a high proportion of CEE's overall spending on industry, and even national funds, as well as loans and grants from other international institutions are often linked to the OPs. This means that transnationally defined policy concepts and priorities considerably shape the industrial policies of these member states. The EU's impact, however, is not limited to material incentives, but also includes ideational and institutional elements. Both before and after the accession, the EU trained public servants and sought to develop member states' institutions in charge of fund management to preempt corruption and wasting of resources (Bailey & De Propris, 2004; (Bruszt and Vedres, 2013).

Nevertheless, the effectiveness of these transnational tools depends crucially on domestic agency, more specifically on domestic institutional capacities. This is especially true when the tools require not only regulation, as in the case of the state aid regime, but positive intervention, as in the case of cohesion policy. While the Commission is closely involved in the formulation of the national OPs, it has no direct control over implementation. Moreover, while the stated policy objective of the funds is to help weaker players, they are allocated competitively which may favor firms with greater ability to formulate projects and navigate through the application process. Finally, while the EU funds to private firms follow the same rules as those of state aid – that is, they are bound by the regional ceilings and indexed to the size of the project so that larger investments receive proportionally lower funding – they never cover the entire cost of the project. This means that to be successful, the applicants must also have sufficient own resources or access to other funding.

In these circumstances, achieving the goals of transnational industrial policy greatly depends on the capacity of domestic institutions to provide consulting services to SMEs, assist their applications, and help them to leverage complementary funding. Without this domestic institutional support, EU funds risk becoming just another source of subsidies for large, powerful companies instead of diversifying spending from these firms to SMEs. In the next section we investigate whether EU funding in the automotive industry in Poland and Romania has avoided this risk, and to what extent it reflects the original objectives of transnational industrial policy.

3. Distribution of EU funds to the automotive sector in Poland and Romania

The following analysis relies on a unique dataset in which we combined information on company size, ownership, employment, and financial performance, with data on EU

Table 1. Key characteristics of the Polish and Romanian automotive industry (data for foreign-owned firms in parentheses).

Country	Firm size	Number of firms	Share (%) from total number of firms	Number of employees	Share (%) from total employee	Total operating revenue (mn EUR)	Share (%) from total operating revenue
Poland	Micro	108 (19)	13.11% (2.31%)	397 (88)	0.15% (0.03%)	44 (12)	0.10% (0.03%)
	SME	486 (150)	58.98% (18.21%)	36,227 (12,804)	14.09% (4.98%)	3525 (1701)	7.63% (3.68%)
	Large	230 (183)	27.91% (22.21%)	220,524 (194,847)	85.76% (75.77%)	42,607 (37,599)	92.27% (81.43%)
Total		824 (352)		257,148 (207,739)		46,176 (39,312)	
Romania	Micro	126 (10)	23.95% (1.90%)	465 (48)	0.20% (0.02%)	26 (8)	0.12% (0.04%)
	SME	267 (115)	50.76% (21.87%)	18,416 (9463)	7.91% (4.06%)	1120 (784)	5.18% (3.62%)
	Large	133 (106)	25.29% (20.15%)	213,840 (195,319)	91.89% (83.93%)	20,489 (19,287)	94.70% (92.81%)
Total		526 (231)		232,721 (204,830)		21,635 (20,079)	

Note: The figures in parentheses refer to foreign-owned firms. Firm size is determined according to the number of employees and turnover. All the employment and financial figures reflect the latest available data (2014–2016).
Source: The authors' own calculation based on EMIS and D&B databases.

Table 2. Contracted EU funding to the automotive industry in Poland and Romania (2007–2013 budget period).

Country	Firm size	Number of auto-motive firms receiving EU funds	Number of funding contracts	Share (%) of funding contracts from automotive contracts	Total EU funding (mn EUR)	EU funding per contract (mn EUR)
Poland	Micro	10	12	2.70%	1.57	0.13
	SME	128	313	70.34%	52.14	0.17
	Large	61	120	26.97%	243.53	2.02
Total		199	445	100%	297.24	0.67
Romania	Micro	1	1	0.79%	0.13	0.13
	SME	44	64	50.80%	27.36	0.43
	Large	39	61	48.41%	113.48	1.86
Total		84	126	100%	140.97	1.12

Note: Based on funding contracts signed until November 2016.
Source: The authors' own calculation.

contracts. In the first step, based on industry codes, we identified both carmaker and supplier companies active in the automotive industry and cross-checked the information obtained from commercial databases[1] with the records of the national automotive industry associations.[2] We considered only those active companies that reported recent financial, employment, and ownership data. The resulting dataset has 824 Polish and 526 Romanian firms. Next, we matched the firm-level data with the publicly available information on individual contracts of EU-funded projects from the 2007–2013 programming period.

Following the European Commission's guidelines (European Commission, 2003), we classified the firms by size (micro-, SME, and large enterprises), and by ownership (foreign or domestic, based on the country of registration of the ultimate owner). Table 1 summarizes their key characteristics. Not surprisingly, while the majority of firms are micro-enterprises and SMEs, the large companies dominate the sector both in employment and revenue. Furthermore, the overwhelming majority of the large firms are foreign-owned. Our dataset thus reflects the well-established fact that the automotive industry in CEE is entirely dominated by large, mostly foreign-owned businesses on which the sector's future development depends (Pavlínek, 2017). With such dependence on a handful of large, highly mobile companies in a key industry, it is no wonder that domestic investment promotion policy has been heavily skewed in their favor (see also Bohle, 2006).

The EU funds, however, are designed specifically to counter this bias. The programmatic objectives of the EU cohesion policy insist that the majority of funding should be allocated primarily to smaller firms. Both Poland and Romania tried to resist this demand, pointing to the large firms' contribution to the countries' overall competitiveness, but they received limited concessions from the Commission.[3] This is evident from the design of the OP Innovative Economy in Poland and Increase of Economic Competitiveness in Romania, which were the main channels of EU funds to private firms in 2007–2013.[4] In Poland, 70% of the resources in the OP Innovative Economy were explicitly reserved for SMEs; while large firms were allowed to bid for funding mostly under budget lines targeting strategic investments, R&D and Innovation. (Ministry for Regional Development, 2009). In Romania, too, allocations to large firms were limited to 20% in the budget line

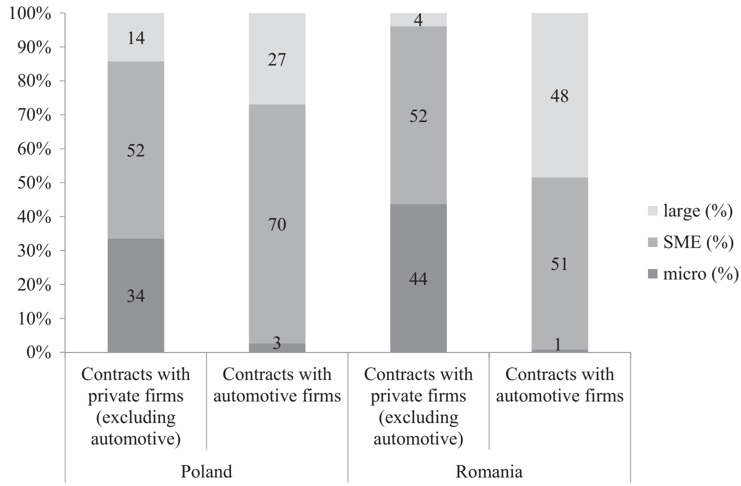

Figure 1. Distribution of EU funding contracts among private firms and in the automotive industry by firm size in Poland and Romania (2007–2013 budgetary period).
Note: a two-sample Z test for proportions ($z = 4.09$; $p < 0.01$) confirms that the share of contracts with automotive SMEs significantly differ between Poland (70%) and Romania (51%).
Source: the authors' own calculation.

supporting capital investments. Nevertheless, no such restrictions were imposed in priority areas promoting R&D and energy efficiency, but the amount of funding available through these channels was also much smaller. Moreover, to ensure adequate attention to SME projects, separate intermediary bodies were set up to oversee applications by SMEs (Ministry for SMEs, Trade, Tourism and Liberal Professions in Romania and the Polish Agency for Enterprise Development [PARP] in Poland).[5]

To what extent does funding to SMEs reflect these programmatic efforts to increase their access to EU resources? Overall, the results seem promising: excluding the automotive sector, only a small fraction of the beneficiaries were large enterprises (8% in Poland and 3% in Romania) and their share of the total number of funding contracts was also low (14% in Poland and 4% in Romania).

In the automotive industry, however, the situation was very different. In Poland, 27% of all the automotive funding contracts were signed with large firms, and in Romania they won nearly half of the contracts (48%; Table 2).[6] In both countries over four-fifths of all the EU funding distributed to the automotive sector has been secured by large companies (82% in Poland and 81% in Romania), and more than a quarter of the large firms in this sector received at least some EU funding (29% in Poland and 27% in Romania). Large enterprises were also among the biggest beneficiaries: in Poland, the largest contract was signed with Bridgestone, which received EUR 24 million for upgrading its tire factory in Stargard, followed by Fiat's EUR 20 million for extension of an engine plant in Bielsko-Biała. In Romania, the largest grant (EUR 19.5 million) went to Romcab, a domestically-owned manufacturer of automotive conductors and wiring, followed by EUR 10.4 million to Renault's engineering center. What is more, the vast majority of these projects involved purchase of capital equipment and services and only a tiny portion was genuinely related to R&D and innovation activities (Šćepanović and

Medve-Bálint, 2019). The above figures reflect the concerns of the dependency argument and suggest that in this sector the ambitions of the EU's transnational industrial policy have been heavily tempered by the large firms' structural dominance and superior fund absorption capacity.

However, a closer look at the data reveals a more nuanced picture. To begin with, the two countries show different patterns of territorial distribution of funding. As the automotive industry is geographically strongly concentrated, it is not surprising that a handful of regions receive most of the funding: in Romania, out of 43 counties, Argeş, Bucureşti, Mureş and Sibiu received 70% of all EU support to the automotive industry and in Poland 3 out of 16 voivodships accounted for 57% of all EU grants (Dolnośląskie, Śląskie, and Wielkopolskie). But whereas these three Polish regions are the hubs of the Polish automotive industry, and their weight in terms of the number of firms, sectoral employment and revenue is similar to their share of funding, the four Romanian regions account for just slightly above a third of the sector's firms and employment and less than half (45%) of the revenue.

Similar differences exist with regard to the funding for SMEs. Most importantly, a significantly larger proportion of the automotive SMEs benefited from EU funds in Poland – 26%, compared to just 16.5% in Romania.[7] Moreover, 70% of all the automotive contracts in Poland went to SMEs compared to only 51% in Romania (Figure 1). Furthermore, while average funding for a single contract with a large firm was at a similar level in both countries (EUR 2.02 million in Poland vs. EUR 1.86 million in Romania), the average size of the contracts with SMEs reveals a big gap (EUR 0.17 million in Poland vs. EUR 0.43 million in Romania).[8]

These differences suggest that the Polish automotive SMEs performed far better at accessing EU funds than similar firms in Romania. Not only was more money channeled to Polish SMEs, but a considerably greater proportion of them in the otherwise much larger Polish industry benefited from EU funds. The Polish state also demonstrated ability to effectively administer a greater number of contracts to a broader range of beneficiaries, whereas Romania showed a clear preference for larger and therefore more easily managed contracts.

We argue that the observed differences are not accidental but owe to differences in state capacities, specifically to the different capacity of the domestic institutional networks to promote the development of SMEs and help them access funding opportunities. The superior capacities of the Polish state both in terms of fund administration and maintenance of a support network for SMEs have resulted in a more inclusive funding pattern despite the similarly powerful presence of large players. Meanwhile, in Romania, weak state capacities impede the use of EU funds according to the objectives of transnational industrial policy. This is because the administration, management and implementation of EU-funded projects require strong bureaucratic capacities. If those are insufficient, it becomes more convenient to disburse large amounts of funds to few big enterprises with high absorption capacity instead of contracting the same amount to hundreds of small businesses.[9] Consequently, the combination of weak state capacities and low institutional support for SMEs with the presence of large, powerful companies in a key economic sector translated into a less inclusive, less diversified, and more concentrated distribution of EU support in the Romanian automotive sector. The next section brings more insight into the evolution and organization of institutional structures that determine the difference in the outcome of transnational policy in the two countries.

4. Domestic state capacities in the transnational integration regime

What do these institutional support structures look like, and where do they come from? This is a question that has preoccupied development literature for decades, and we can hardly hope to answer it in this short section. We do, however, hope to lay ground for further inquiry by highlighting the confluence of political competition, ideology, and transnational influences that have shaped the institutional environments of Poland and Romania before and after their accession to the EU.

4.1. Poland

Despite its general commitment to FDI-led development, the Polish state has been building up support networks for smaller domestic firms from the very start of transition. Following a brief and failed attempt of neoliberal shock-therapy after the change of regime, successive Polish governments have made use of more interventionist industrial policy, establishing public agencies and programs aimed at development of domestic enterprises, in particular SMEs. This 'developmentalist' orientation survived despite changes in ideological positions and policy toolkits: in the 1990s, both the Solidarity governments and the coalition led by the communist successor party adopted an interventionist stance and continued many of each other's industrial policy initiatives (King & Sznajder, 2006). Such broad cross-party agreements – although often emerging as a consequence of the incumbents' internal political divisions – were also observed in other policy fields such as in the case of pension reforms (Makszin, 2013), and became even stronger after the turn of millennium. Following its re-election in 2011, the coalition led by the center-right civic platform (PO) launched a series of programs to promote Polish industry, and these were added to by the successor government of the conservative law and justice (PiS) party (Kozarzewski & Bałtowski, 2017). A particular example for policy continuity is a loan program called Technology Credit Fund (*Fundusz Kredytu Technologicznego*), which is run by the state development bank (*Bank Gospodarstwa* Krajowego, BGK). The program is open exclusively to SMEs that received commercial loans to develop new technologies. BGK pays part of the loan as a 'technological premium' to the applicant's bank, which eases the financial burden on the company and also reduces credit risk.[10] It was initiated in 2005 by a left-wing government and continued to operate during the three successive governments that extended the program by incorporating EU funding both in the 2007–2013 and 2014–2020 funding periods (Kiełek-Więcławska & Stawasz, 2015).

The high degree of policy continuity facilitated the development of a network of public agencies which by now constitute a thick background for industrial policy. Importantly, many of these agencies have received financial and operational support from the EU, which reinforces the transnational character of industrial policy.

At the time of writing[11], the most important institutions serving industrial development belong to the Polish Development Fund (PFR Group), which was established in 2016 by the PiS government. The creation of PFR was a main step towards accomplishing the Strategy for Responsible Development (Ministry of Development, 2016), which is a long-term economic roadmap for Poland drafted by Mateusz Morawiecki, current Prime Minister and former Minister of Development. The document reinforces the state's developmentalist direction and specifies re-industrialization and the strengthening of innovative local companies (especially SMEs) as the cornerstones of the future ('more Polish economy in the Polish economy') while also remaining open to foreign investors in the high value-added segments. The Plan considers EU funds vital for further investment promotion.

A key member of the PFR Group is the Industrial Development Agency (ARP), which dates back to 1990. Initially, it facilitated privatization (Shields, 2004) but later gained a prominent role in firm restructuring. In the mid-1990s ARP was also critical in establishing regional development agencies (RDA), which, though varying in size and competence, provide crucial low-cost consulting and training services to firms (McDermott, 2004, pp. 208–209). Already at this stage the EU's role proved decisive: the RDAs were initially financed through a PHARE project.[12] Later, some RDAs became PHARE managing units, channeling support for the creation of regional business infrastructure, and after the accession the largest of them took charge of the implementation of SME-supporting EU programs as intermediary bodies cooperating with the Polish Agency for Enterprise Development (PARP; Ferry, 2007).[13]

PARP is the most important central body supporting SMEs. It was founded in 2001 with the assistance of PHARE funds, as a more expansive version of its predecessor, Polish Foundation for SME Promotion and Development. Soon, PARP became responsible for the management of national and EU funds for entrepreneurship (Grabowski, Pamukcu, Szczygielski, & Tandogan, 2013), and in 2007 it led the establishment of the National System of Services (*Krajowy System Usług*, KSU) – a network of institutions that provided free services to SMEs, including support in writing applications for EU funds. The KSU's financing originally came from the EU[14], but now it operates on commercial basis[15] and consists of country-wide Consultation Points that advise SMEs on commercializing new technologies, access to EU funds and enterprise management (Woodward, Wojnicka, & Pander, 2012).

Other initiatives have been focused on helping SMEs enter the large firms' value chains at a higher level, through more intensive technological cooperation. The National Center for Research and Development (NCRD) channels EU funds through the Fast Lane (*Szybka Ścieżka*) program[16], which encourages the cooperation between large enterprises and SMEs involved in industrial research and development.[17] Drawing on its own resources, ARP has taken a similar initiative called Technology Transfer Platform (*Platforma Transferu Technologii*), which aims to connect SMEs with large companies in need of innovative solutions.[18]

Sectoral programs also foster cooperation among firms, investors, consultants and research units. Besides managing support plans in the energy, railway and chemical industries,[19] in 2014 the NCRD launched the Innomoto program in the automotive sector. This initiative, which is partly funded from OP Smart Growth and aims at increasing R&D and technological innovations, was established with the involvement of the most important representatives of the domestic automotive industry and is expected to further facilitate technological cooperation between the large firms and SMEs.[20]

In sum, the Polish political elite's lasting consensus over the importance of local SME's for the country's development has ensured the continuity of industrial policy programs and created strong capacities for upgrading (see also Markiewicz, this issue). The Polish state used the resources of the EU's transnational industrial policy not only to support individual firms, but also to build up a network of agencies that assist SMEs. This is in sharp contrast to Romania where generous funding for individual firms, both foreign and domestic, was not accompanied by a more comprehensive institutional support to entrepreneurs (see Vukov, this issue).

4.2. Romania

Romania is a relative latecomer to FDI-led development: for most of the 1990s the successive governments tried to preserve a system in which a degree of liberalization was combined with protection of the key domestic firms and industries, often by keeping them in public hands (see Vukov, this issue). The resulting 'cocktail capitalism' (Cernat, 2006) suffered from anemic economic performance, and also ran afoul of the EU's market rules. As the negotiations for the country's EU membership began, Romania took a sharp turn towards radical liberalization (Ban, 2016; Bohle & Greskovits, 2012). The main thrust of industrial policy since has been to attract foreign investors, with a few half-hearted attempts to promote local SMEs (Ban, 2016).

Under the EU's tutelage, Romania's earlier industrial policy tools were deemed non-transparent and fiscally unsound, and were replaced by a more streamlined system which distributed modest amounts of aid on a fully competitive basis. Transparency, competitive allocation and discouragement of 'sectoral' (i.e. rescue and restructuring aid) in favor of 'horizontal' (new investments) policy goals benefited newly arriving foreign firms over the incumbent players who still struggled with the legacies of transition. Foreign investment was actively encouraged by the EU, which saw it as the fastest tool to revive Romania's flagging economy (European Commission, 1997).

With the shift away from 'domestic champions', the post-2000 period also saw a wave of policy efforts directed at SMEs. This included creation, in 2000, of a Ministry for SME, three years later transformed into the National Agency for SMEs and Co-operation (NASMEC). The 2004 Act on SMEs and the 2004–2008 Strategy for support to the SME sector laid the legal basis for assisting the development of small businesses. With active support of the EU's PHARE program, NASMEC's responsibilities and budget also increased, reaching about EUR 60 million in 2006. The agency's administrative and programmatic capacities were further strengthened in anticipation of its future responsibilities for the management of SME-destined portion of the EU funds. In 2004–2006 NASMEC benefited from about EUR 7 million via PHARE-funded technical assistance and twinning projects (Government of Romania, 2007).

The spread of policy ideas from the EU level as well as the opportunities created by its policies in this period gave rise to a host of other initiatives for development of local business support structures: incubators, industrial parks, technology and science parks, and clusters. Despite all these efforts, however, the weakness of domestic institutions remains starkly apparent, especially when compared to Poland. First, the institutional architecture for the support of SMEs is relatively young, and the rapid multiplication of programs and institutions has made the system less coherent as well as less transparent for the potential beneficiaries. Nearly half of SMEs are not at all familiar with the existence of these support structures, while many others consider them irrelevant to their own needs (Hunya, 2011).

Part of the problem lies with the fact that, unlike Poland's, Romania's institutional system has remained heavily centralized. In 2002–2006, in order to comply with the requirements of the EU's regionally-based cohesion policy, Romania established eight 'development regions', each presided over by an RDA. RDAs are the bodies formally in charge of implementing regional development policy, including the development of business support systems. But whereas in Poland RDAs had a chance to build up their capacities and links to the local business communities over a longer period, Romanian RDA's lack both experience and authority. As Romania's 'regions' are little more than statistical units without legislative or executive powers, the RDAs are in a weak administrative position, without much ability to either formulate effective development plans or mobilize local administration for their implementation (Ranga, 2010; Suciu, 2013).

NASMEC, for its part, has also been slow to set up regional offices, and was therefore often seen by firms as a distant bureaucratic body with little awareness of the needs of local companies (OECD, 2005). When local offices were eventually set up in 2007, they remained weakly equipped and understaffed, without much capacity to assist firms beyond offering basic information on NASMEC's programs. The situation was further aggravated by an underdeveloped private consultancy sector: in 2008, 40% of all consultancy firms were based in Bucharest-Ilfov region and they accounted for two-third of all the turnover generated in the entire sector (Hunya, 2011). As we have seen in the previous section, this lack of domestic infrastructure is clearly reflected in the limited access of automotive SMEs to EU funding, as well as in the skewed distribution of funding in terms of company size and location.

Finally, unlike in Poland where the cross-party consensus on industrial development ensured remarkable policy continuity, in Romania political power struggles both between and within governing parties often led to disruptive institutional overhauls. The collapse of the coalition government of the National Liberal Party (NLP) and Democratic Party (DP) just before the start of the 2007 financing period resulted in a minority government led by NLP and a ministerial reshuffle which, among other, assimilated NASMEC into a newly founded Ministry for SMEs, Trade, and Business Environment. Two years later, the NLP lost the election, and the incoming government dissolved the Ministry for SMEs and integrated it with the Ministry of Economy, thus merging all bodies in charge of EU funds to the private sector under a single roof. In 2012, following a corruption scandal and a temporary funding freeze by the EU, the Ministry transferred the responsibility for SME applications to the RDAs, but did not allocate additional resources to enable these bodies to manage their new duties. The reason for this major institutional reorganization was the discovery of a complex embezzlement scheme which involved more than 100 'ghost' companies misappropriating more than EUR 20 million (Surubaru, 2017b).

The systematic weaknesses in Romania's administrative capacity, political instability, and widespread corruption precluded the efficient use of EU funds: in 2007–2013 five out of the seven Romanian OPs had to be either interrupted or suspended by the EU because of serious irregularities affecting management and implementation (Surubaru, 2017a). Furthermore, the frequent changes in government[21] and the politicization of public administration involved high staff turnover in the agencies responsible for EU funds and resulted in repeated institutional reshuffling (Surubaru, 2017b, 2017a). All of this prevented the gradual expansion of the institutional support network for SMEs that we observed in Poland.

There are, however, some exceptions to this generally weak institutional landscape. One such is the West region of Romania, whose RDA has managed to create a developmental coalition with local county offices, and mobilize funding from various international projects for the improvement of business environment. Not incidentally, this region is also home to some of the most successful examples of inclusive industrial policy: the Automotivest cluster of automotive firms is based around large international firms but has a strong supplier development program supporting their linkages to local firms, and the Tehimpol incubator for high-tech start-ups (Vukov, this issue). While transnational integration has succeeded in providing opportunities for such local development initiatives, at the national level most programs have been undermined by a weak, unstable, and highly politicized institutional environment.

5. Conclusion

With the rise of global value chains and the deepening of transnational regulation, the rules of the game of economic development have changed. Foreign capital has taken the pride of place as more and more countries abandoned the hopes of breeding their own domestic industrial champions. This has given rise to fears of a new type of dependency, in which the race to attract foreign capital, combined with the loss of domestic policy tools, would drain states' resources and limit prospects for a more comprehensive and diversified form of development.

In this paper, we set out to explore an alternative proposition: that transnational integration, at least in some of its forms, may provide developing countries with alternative tools to resist the downsides of this structural dependence on FDI, by replacing domestic with transnational industrial policy. In doing so, we build on the argument that the TIRs – the main vehicles through which integration has been taking place in the past decades – do not merely amplify, but *manage* globalization. In other words, while constraining their members' autonomy to an unprecedented degree, they also provide them with additional resources to advance upgrading.

Using the EU as the most prominent example of this approach, we focused on a particular tool that the EU offers to its members: transnational funding for development of SMEs and investments into high value-added activities such as research and innovation. We studied the distribution of EU funding to the automotive industry in Poland and Romania – two countries often invoked as examples of DMEs – to gauge the extent to which it complied with the goals of transnational policy.

Our findings give reason for some cautious optimism. On the one hand, a very large portion of funding that in theory should be earmarked for development of SMEs has been allocated to large, mostly foreign, companies in both Poland and Romania. Their enormous market power, superior competitiveness, and absorption capacity thus present real limitations on the ability of transnational industrial policy to foster broad industrial upgrading. At the same time, we do find some evidence that the transnational rules have tempered the bargaining power of these firms, because the share of EU funding they received is lower than their weight in the industry's output or employment, and much lower than their share of domestic state aid. One should bear in mind that we had purposely chosen the automotive as a limiting case. The industry's top-heavy structure and enormous weight in the economies of both countries make it especially difficult to ignore the demands of its lead firms. Even moderate evidence of effectiveness of transnational policy in terms of diversification of funding is therefore encouraging, and we expect research in other sectors to uncover even greater scope for countering the structural constraints of dependent development through transnational industrial policy.

Moreover, concerning the portion of funding that does get allocated to the SMEs, we find significant differences between the two countries. While in Romania a small number of relatively large SMEs absorb all funding, in Poland it is more evenly distributed across regions and firms. We explain the more distributive pattern of allocation in Poland with greater domestic state capacity to create and maintain institutions which support SMEs and help them integrate into global value chains.

Our findings thus confirm the view that domestic institutional quality represents a critical ingredient for successful adaptation to the intensifying competition triggered by globalization (Weiss, 2004). More importantly, however, we also find that transnational agency can be instrumental for the strengthening of domestic institutions: nearly all public bodies that have played a role in facilitating the access of Polish SMEs to EU funding, as well as in supporting their development and upgrading more generally, have at some point received technical and financial support from the EU. In combination with a broad cross-party consensus on development policy (Markiewicz, this issue) this allowed Poland to develop a solid institutional environment that can leverage transnational resources for domestic growth. In Romania, similar efforts on the EU's part did not yield the same results and the institutions in charge of SMEs remain weak. In line with Ban (2016) and (Vukov, this issue) we trace this failure of transnational policy to enduring political instability that precluded the emergence of a broad developmentalist consensus of the kind observed in Poland and instead led to corruption and policy discontinuity.

We are well aware that this is only the start of the enquiry. The EU's transnational industrial policy has been at work for much longer in Poland than in Romania, and has also changed shapes and objectives several times in the course of these countries' integration into the EU. In spite of the various benefits it may bring, by no means transnational industrial policy represents a fool-proof solution to the pressing issues commonly associated with promoting domestic industries in DMEs. Difficulties with access to finance and the resulting liquidity problems still feature among the biggest challenges to SMEs not only in Romania (Anton & Onofrei, 2016) but also in Poland (Klonowski, 2012). Development literature has long pointed to the importance of institutions for economic growth, but it has produced few answers on how the 'right' institutions might be acquired. Our paper provides empirical support for the argument that transnational industrial policy can fruitfully contribute to this process, but the precise mechanisms of the influence, and the way they interact with various sectoral and national realities, deserve to be studied in much greater depth.

Notes

1. Emerging Markets Information System (EMIS) and Dun & Bradstreet (D&B).
2. Polish Chamber of Automotive Industry and Automotivesuppliers.pl in Poland; the Association of Automobile Manufacturers (ACAROM) in Romania.
3. Interview with a state aid expert working for a private consulting agency, Warsaw, 30 November 2017.
4. In the 2007–2013 programming period, the total budget of EU funds amounted to EUR 67.3 billion in Poland and EUR 19.7 billion in Romania (European Commission 2007). Of this, EUR 19.1 billion (30%) in Poland and EUR 2.8 billion (15%) in Romania benefited private firms (expressed in 2016 EUR).
5. Interviews with the former Deputy CEO of ARP, Warsaw, 30 November 2017 and with the former President of PARP, Warsaw, 1 December 2017.
6. While the contribution of the automotive sector to the manufacturing value added is similar in both countries (9% in Poland vs. 12% in Romania), in Romania the automotive industry received a much greater share of EU support: 5.33% of all EU funding to private firms went to the automotive compared to 1.56% in Poland.
7. A two-sample Z test for proportions confirms that the difference in the share of funded SMEs is significant ($z = 3.08$; $p < 0.01$).
8. An independent samples t test confirms the significant difference between the average value per contracts with SMEs in the two countries ($t_{(375)}=7.282$; $p < 0.01$).
9. This point was mentioned by an interviewed Polish state aid expert, Warsaw, 30 November 2017.
10. Interview with the former Deputy CEO of ARP, Warsaw, 30 November 2017.
11. October 2018.
12. PHARE (Poland and Hungary: Assistance for Restructuring their Economies) was a developmental assistance program created by the EU in 1989 originally targeting Poland and Hungary. Later, PHARE was extended to all the CEE candidate countries and became one of the most important pre-accession instrument assisting institution-building and economic restructuring.
13. For a list of these RDAs, please consult PARP's website (http://pokl.parp.gov.pl/index/index/1335, accessed on 3 October 2018).
14. For more information consult: https://www.parp.gov.pl/punkty-konsultacyjne-ksu-3 (accessed on 3 October 2018).
15. Interviews with the former Deputy CEO of ARP, Warsaw, 30 November 2017 and with the former President of PARP, Warsaw, 1 December 2017.
16. More information (in Polish) is available in the NCBR's webpage: https://www.ncbr.gov.pl/programy/fundusze-europejskie/ (accessed on 3 October 2018).
17. Interview with a state aid expert working for a private consulting agency, Warsaw, 30 November 2017.
18. Interview with the former Deputy CEO of ARP, Warsaw, 30 November 2017.
19. Interview with a state aid expert working for a private consulting agency, Warsaw, 30 November 2017.
20. Interview with the President of PZPM, Warsaw, 1 December 2017 and information from Innomoto webpage (http://innomoto.com.pl/?page_id=84, accessed on 3 October 2018).
21. Between November 2005 and November 2015, the composition of the governing coalition or the Prime Minister changed ten times in Romania but only three times in Poland (source: ParlGov).

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Notes on contributors

Gergő Medve-Bálint, PhD from Central European University, is a Senior Research Fellow at the Centre for Social Sciences, Hungarian Academy of Sciences and Assistant Professor at the Faculty of Economics, Corvinus University of Budapest. He specializes in political economy and studies the effects of European integration on foreign direct investment, regional development and territorial inequalities in East Central Europe.

Vera Šćepanović, PhD, is a University Lecturer at the Faculty for Humanities, Leiden University. She researches the politics of foreign direct investment in East Central Europe, industrial policy in the EU, and the nature of industrial development in the age of global value chains.

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