

## **ABSORPTION CAPACITY OF EU FUNDS IN ROMANIA**

Lect. Claudiu George Bocean Ph. D  
University of Craiova  
Faculty of Economics and Business Administration  
Craiova, Romania

**Abstract:** Most Central and Eastern European countries have encountered problems in attracting EU structural funds in the post accession period. This paper analyzes the CEE absorption capacity of EU structural funds in 2007-2010, focusing on the case of Romania. Romania recorded at the end of 2010 the lowest rate of payment for contracted grants. Among reasons for poor absorption capacity we have identified a lack of government strategy, poor administrative capacity of central and local public institutions, public-private partnerships failure, deficient human resources.

**JEL classification:** F15, F36, H43, O22

**Key words:** absorption capacity, European Union, European funds, structural funds, contracted ratio, payment ratio

### **1. INTRODUCTION**

The Structural Funds and the Cohesion Fund are financial instruments of the policy of economic and social cohesion. These instruments sustain the reduction of the gap between the development of different regions from the member states and support, to this purpose, the economic and social cohesion. (Droj, 2010)

In financial terms, these instruments take second place as a share of the EU budget after the Common Agricultural Policy. These include:

1. European Development Fund (ERDF),
2. European Social Fund (ESF),
3. Cohesion Fund.

Through these instruments the EU aims to achieve three objectives: convergence, regional competitiveness and territorial cooperation.

Objective “Convergence” endorsing development and structural adjustment of regions lagging behind in development, is funded by ERDF, ESF, Cohesion Fund, covering areas of the regions whose GDP per capita is below 75% of the EU average. This objective targets growth for regions lagging behind, investing in the development of long-term competitiveness, employment, sustainable development, capacity institutional improvement and government efficiency increase.

Objective “Regional Competitiveness and Employment” (funded by ERDF and ESF) supports the regions not eligible for Convergence objective, covering smaller areas, including areas with socio-economic changes in industrial and service sectors, declining rural areas, urban areas in difficulty or dependent on fishing. Under this objective UE aims to anticipate and support economic change in industrialized areas by supporting businesses and individuals.

Objective “European territorial cooperation” (funded by the ERDF) supports regions, counties and transnational areas, covering areas that are the EU internal borders and certain external borders. Under this objective EU aims to strengthen cross border cooperation, transnational and interregional levels.

Since 2012, the EU should begin preparations to establish a new strategy and the amount of funding during 2014-2020. There should be a more complete and effective use of EU funds to achieve objectives within EU 2020 strategy and make the funding process more efficient. On 29 June 2011, the European Commission presented its proposal on EU budget for 2014-2020.

European Commission proposes to allocate 36.7% of seven-year budget for cohesion policy, compared to 35%, as was allocated in the past. The main changes proposed by the Commission are:

- creating an intermediate category of regions whose GDP is between 75% and 90% of average EU GDP. This new category will be added to the two existing (convergence regions and competitiveness regions). The poorest regions and Member States of the European Union would benefit from priority support to reduce economic and social gaps.

- the introduction of conditioning in cohesion policy. Cohesion policy will be based on performance and incentives to implement reforms needed to ensure effective use of financial resources.

- creating a common strategic framework for all structural funds in order to redefining strategy Europe 2020 objectives as priorities for investment.

- European Social Fund (ESF) will continue to have a key role in combating unemployment and high rates of poverty and in achieving the main objectives of Europe 2020 strategy. ESF will represent 25% of the cohesion policy budget (84 billion euros).

## **2. STRUCTURAL INSTRUMENTS IN ROMANIA**

For 2007-2013 the EU allocated to Romania 19,667 billion euros from the Structural and Cohesion Funds. These funds can be accessed through 8 operational programs: Structural Operational Program - Transport, Structural Operational Program - Environment, Regional Operational Program (ROP), Structural Operational Program - Human Resources Development, Structural Operational Program - Increase of Economic Competitiveness, Structural Operational Program -Administrative Capacity Development, Operational Program - Technical Assistance, Operational Programs - Territorial Cooperation. Table 1 shows the operational programs which run structural instruments.

Trough Operational programs Romania runs the projects funded by EU and effectively access the structural instruments. Seven of operational programs are framed within the convergence objective. Documents of the seven operational programs have been developed by the Managing Authorities in coordinating of the Authority for Coordination of Structural Instruments. In addition to operational programs subsequent to "Convergence" objective was developed a series of territorial cooperation programs.

**Table no. 1 Operational Programs in Romania**

<b>Operational Program (OP)</b>	<b>Percentage allocated of the total budget</b>	<b>Structural Instrument</b>	<b>Management Authority of Operational Program</b>
<b>1. Transport OP</b>	23%	Cohesion Fund and European Regional Development Fund	Ministry of Transport
<b>2. Environment OP</b>	23%	Cohesion Fund and European Regional Development Fund	Ministry of Environment
<b>3. Regional OP</b>	19%	European Regional Development Fund	Ministry of Regional Development
<b>4. Human Resources Development OP</b>	18%	European Social Fund	Ministry of Labour, Family and Social Protection
<b>5. Increase of Economic Competitiveness OP</b>	13%	European Regional Development Fund	Ministry of Public Finance
<b>6. Administrative Capacity Development OP</b>	1%	European Social Fund	Ministry of Interior
<b>7. Technical Assistance OP</b>	1%	European Regional Development Fund	Ministry of Interior
<b>8. Territorial Cooperation OP</b>	2%	European Regional Development Fund	Ministry of Regional Development

*Source: Authority for Coordination of Structural Instruments*

European territorial cooperation programs involving cooperation regions with regions of neighboring Romania (in cross-border cooperation), regions in a given geographic area (within the transnational cooperation), and regions from any EU Member State (the inter-regional), through projects managed and administered jointly by partners from participating countries.

### **3. COMPARATIVE ANALYSIS ABSORPTION CAPACITY OF EU FUNDS IN CEE**

During the 2007-2013 ten countries of Eastern and Central Europe were given the structural funds 172,6 billions euros, representing 2.7% of GDP in this period. Table 2 shows the distribution of structural funds among the 10 countries, their share in GDP, amount per capita.

**Table no. 2 EU funds in CEE countries**

	Population (million)	Annual GDP (billion EUR)	GDP per capita (EUR)	EU funds 2007-2013 (billion EUR)	EU funds per capita (EUR)	EU funds per GDP (%)
<b>Bulgaria</b>	7,6	36,0	4764	6,7	882	2,6
<b>Czech Republic</b>	10,5	145,9	13890	26,3	2502	2,6
<b>Estonia</b>	1,3	14,5	10821	3,4	2540	3,4
<b>Hungary</b>	10,0	98,4	9830	24,9	2488	3,6
<b>Latvia</b>	2,2	18,0	7993	4,5	2014	3,6
<b>Lithuania</b>	3,3	27,4	8232	6,8	2035	3,5
<b>Poland</b>	38,2	353,7	9266	65,3	1711	2,6
<b>Romania</b>	21,5	121,9	5682	19,2	895	2,3
<b>Slovakia</b>	5,4	65,9	12149	11,4	2094	2,5
<b>Slovenia</b>	2,0	36,1	17617	4,1	2003	1,6
<b>CEE total</b>	102,1	917,9	8990	172,6	1690	2,7

*Source: KPMG, EU Funds in Central and Eastern Europe, Progress report 2007–2010*

In the four years (2007-2010) of ongoing EU funded programs were signed contracts worth EUR 110.2 billion representing 53% of the total funds. In the same period have made payments representing 17% of the total funds and about a third of the contracted grants. Table 3 presents the projects contracted and payments within the 10 CEE countries.

**Table no. 3 EU funds contracting and payment**

	Available budget 2007- 2013 (billion EUR) including co-financing	Contracted grants 2007-2010 (billion EUR)	Paid grants 2007- 2010 (billion EUR)
<b>Bulgaria</b>	8,0	3,0	0,8
<b>Czech Republic</b>	31,0	17,2	8,1
<b>Estonia</b>	4,1	2,5	0,9
<b>Hungary</b>	29,3	15,0	4,8
<b>Latvia</b>	5,0	3,4	1,5
<b>Lithuania</b>	7,3	5,0	2,1
<b>Poland</b>	82,1	43,5	13,1
<b>Romania</b>	23,3	10,4	1,5
<b>Slovakia</b>	13,4	7,6	2,3
<b>Slovenia</b>	4,8	2,3	1,3
<b>CEE total</b>	208,2	110,2	36,3

*Source: KPMG, EU Funds in Central and Eastern Europe, Progress report 2007–2010*

Romania recorded the lowest rate of payments (7%), while Bulgaria has the lowest rate of contracting of European funds (37%).

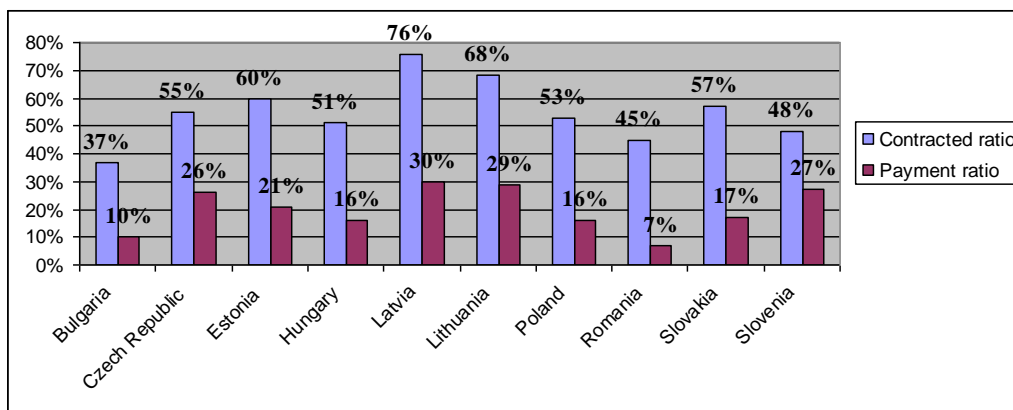


Figure no. 1 Contracted and payment ratios in CEE

In Romania, in terms of contracting the lowest rate is recorded by the operational Transport (15%), followed by Operational Programs Technical Assistance and Increase of Economic Competitiveness. The fewer payments recorded Operational Programs Transport (1%), Environment (2%), Administrative Capacity Development (4%). The highest rates of contracting and payment records Operational Programs Development of Human Resources (72%, respectively 12%) and Regional (70%, respectively 13%).

Table no. 4 EU funds breakdown by OP in Romania

	Available budget 2007-2013 (billion EUR) including co-financing	Contracted grants 2007-2010 (billion EUR)	Paid grants 2007-2010 (billion EUR)	Contracted ratio	Payment ratio
<b>Human Resources Development OP</b>	4,089	2,929	476	72%	12%
<b>Regional OP</b>	4,384	3,074	589	70%	13%
<b>Environment OP</b>	5,611	2,390	122	43%	2%
<b>Increase of Economic Competitiveness OP</b>	3,011	1,016	267	34%	9%
<b>Administrative Capacity Development OP</b>	246	80	11	33%	4%
<b>Transport OP</b>	5,698	836	47	15%	1%
<b>Technical Assistance OP</b>	213	57	10	27%	5%
<b>TOTAL</b>	23,251	10,383	1,522	45%	7%

Source: KPMG, EU Funds in Central and Eastern Europe, Progress report 2007–2010

#### 4. FACTORS INFLUENCING ABSORPTION CAPACITY

The absorption capacity is generally defined as the “capacity of the countries on low incomes to absorb productively a large volume of foreign aid”, the central issue

here being to prioritize the granted aid (Bourguignon and Sundberg, 2006). Šumpíková and all defined absorption capacity as “the extent to which a state is able to fully spend the allocated financial resources from the EU funds in an effective and efficient way. From this perspective, the absorption capacity of European funds shows the functionality of public institutions, capacity to make necessary adjustments to the administrative level to fulfill the minimum economic and administrative criteria for attracting EU funds. (Cace et al, 2009).

Horvath (2004) considered based on past experiences that there is a “golden rule” of EU funds absorption: the smaller the number of institutions involved in implementation of structural instruments the more likely the state record a high rate of absorption of structural funds.

Wostner (2008) establish three specific factors that influence absorption capacity:

- The macroeconomic absorption capacity that depends largely on GDP;
- The managerial-administrative absorption capacity which refers to the abilities and skills to make planning, to evaluate projects, to ensure coordination between the project partners, to deal with administrative and reporting documents required by the Commission, and to finance and supervise implementation suitably.
- Finally, the financial absorption capacity, which refers to the aptitude to co-finance EU grants, to plan and guarantee national contributions in multi annual budgets.

Georgescu appreciate that Romania's incapacity to use EU funds is endemic, even if it can be explicated by the action of various causes, including blockage in public administration under the circumstances of general and local elections in 2008 and 2009 (Georgescu, 2008). Due to reduced absorption of structural funds Romania is a net contributor to EU budget. This will increase the gap to the other CEE countries and the failure of the Convergence objective. Zaman and Georgescu (2009) considers that the main reason for poor absorption of EU funds is the lack of transparency of central government at the level of management and the ministries involved, unable to admit the existence of vulnerabilities, to identify and fix them. The central authority shows a truncated image of contracting and payments ratios, highlighting the positive and ignoring negative ones.

Berica (2010) considers that there are two types of factors that influence the absorption of EU funds:

- internal factors related to the beneficiaries of these funds,
- external factors related to the institutions that monitor the implementation of European projects.

My research was conducted through review of literature and direct observation of running European projects. The research can be classified as exploratory, representing an initial study that deals with the issue of poor absorption capacity of European funds in Romania.

Following my experience and research conducted, among the internal factors I have identified:

- lack of know-how in writing projects and the reluctance of beneficiaries to seek expert advice,
- underestimating the resources needed to carry out actions,
- overestimation of the capacity of carrying out activities to impress the evaluation committee,
- wrong choice of target groups,

- lack of funds necessary to ensure co-financing,
- non-involvement of partners in the writing projects where projects are partnerships,
  - disagreements between partners regarding division of responsibilities and financial resources.

Among the external factors that negatively influence the absorption of structural funds I have identified:

- lack a clear strategy at government level to facilitate absorption of EU funds,
- administrative incapacity of institutions designated to runs projects financed from structural funds (managing authorities and intermediate bodies),
  - fraud made by beneficiaries leading to blocking the entire line of funding,
  - economic crisis has reduced co-financing capacity of potential beneficiaries,
  - bureaucracy in the Romanian and European institutions leading to extensions of time (evaluation, selection and payment terms).

## **5. CONCLUSION**

Based on the reasons for low capacity to absorb EU structural funds, in my opinion, by the deadline set for the 2007-2013 programming period is necessary to adopt a program of measures to strengthen administrative and financial capacity, as follows:

- establish a system of rewards and sanctions to accelerate payment processes,
- reduce / eliminate the current deficit of capacity and skills that continue to affect implementation of programs, thus jeopardizing the absorption,
  - better targeting of funds through a more accurate interpretation priority objectives,
    - ensuring competent human resources necessary for policy implementation and evaluation of the effectiveness of operational programs,
    - designing a system for planning applications in order to coordinate the timing of launches calls for proposals, thus preventing the occurrence of excessive peaks in the receiving and processing applications,
      - review of public procurement legislation to remove legal and institutional barriers that hamper the absorption of structural funds,
      - granting a greater role of the eligibility criteria than project selection criteria in filtering of applications,
        - exempt SMEs from the obligation to provide pre-financing guarantees, which reduce liquidity, especially when working with low budgets and moderate risk,
        - assuring coherence between the strategies related to Structural Funds, on the one hand, and national policies, programs and measures supporting socio-economic development, on the other hand,
        - use of external grant allocation without national co-financing or small national co-financing,
          - setting realistic clear and coherent objectives, and a comprehensive indicator system of communication with potential and actual beneficiaries,
          - harmonization of eligibility criteria with financial evaluation criteria of banks,

• Letters of Comfort recognition issued by banks and using them as part of the documentation submitted to obtain structural funds.

To summarize, it is necessary to classify interventions according to the total budget, complexity, risk implementation and sustainability of projects and redefining selection mechanisms, so that it reflect the new classification. It should be also explored the possibilities of reallocating funds to counter the current economic crisis.

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