

## CONSIDERATIONS ON POTENTIAL DETERMINANTS OF STRUCTURAL AND COHESION FUNDS ABSORPTION

Lect. Oana GHERGHINESCU, PhD  
 University of Craiova  
 Prof. Andreas KOLODZIEJAK, PhD  
 European Commission, Brussels  
 Ec. Gheorghe GHERGHINESCU  
 National Bank of Romania, Craiova Branch

### Introductory remarks

The main focus of the cohesion policy and its instruments between 2007 and 2013 is on ensuring more growth and jobs for all regions and cities of the European Union<sup>1</sup>. During this period, the greatest investment ever made by the EU through cohesion instruments is worth over 300 billion euros (in 2004 prices) to support regional growth agendas and to stimulate job creation. Out of this amount, 82% will be concentrated on the “Convergence” objective, under which the poorest Member States and regions are eligible. In the remaining regions, about 16% of the Structural Funds will be concentrated to support innovation, sustainable development, better accessibility and training projects under the “Regional Competitiveness and Employment” objective. Another 2.5% finally are available for cross-border, transnational and interregional cooperation under the “European Territorial Cooperation” objective. Certain spending targets have been agreed upon to pursue the objectives of the Growth and Jobs Agenda: In the case of the “Convergence” objective, the target is 60%, and in the case of the “Regional Competitiveness and Employment”

objective, the target is 75% of the total available funding, which needs to be “earmarked” for interventions supporting, e.g. research and innovation, the information society and sustainable development.

The functioning and implementation of the Structural Funds is based on four principles:

1. **Concentration** of measures on the priority objectives for development.
2. **Programming**, which results in multi-annual development programmes, the result of a process leading to a decision taken through partnership. The process has a number of stages. The adopted measures then become the responsibility of the managing authority.
3. **Partnership**, which implies the closest possible co-operation between the Commission and the appropriate authorities at national, regional or local level in each Member State from the preparatory stage to the implementation of measures.

4. **Additionality**, which means that Community assistance, complements the contributions of the Member States rather than reducing them. Except for special reasons, the Member States must maintain public spending on each Objective at no less than the level reached in the preceding period.

Furthermore, relations between the Commission and the member States are governed by the principle of **subsidiarity**, which is enshrined in the

<sup>1</sup> European Commission (2006), “Fourth progress report on cohesion – The Growth and Jobs Strategy and the Reform of European cohesion policy”, Brussels.

Treaty of Maastricht. In general terms, this means that a higher authority may not and must not act if an objective can be achieved satisfactorily at a lower level. One consequence of this is that it is up to the managing authorities appointed by the Member States to select the projects to be financed and to supervise their implementation.

The role of structural funds (transfers from the EU budget) in regional development has been designed for various reasons, mainly because markets left by themselves might fail to ensure economic growth due to externalities (infrastructure, environment issues), market rigidities (lack of labor market mobility), and incomplete information. In such a context, the importance of ensuring high levels of absorption, especially in the deprived regions, is crucial.

The priorities of the new financing framework 2007-2013 are different from the ones of the Agenda 2000, which had been focused on preparing the round of enlargement from 2004. The main differences result from introducing the reform of the Common Agricultural Policy and the increase in the efficiency of the structural funds and the cohesion fund in the less developed regions and Member States.

The financing framework 2007-2013 aims at strengthening the success of the enlargement process and the increase in the EU competitiveness, stimulating economic growth at European level, job creation, developing the concept of European citizenship and strengthening the role of the EU at global level.

During the period 2007-2013, the cohesion policy will benefit of 35,7% of the total EU budget, which in current prices equals to approximately 350 bill. euro. The allocation of these funds at European level is done according to objectives and Member States (Table 1).

**Table 1 - Allocation of structural and cohesion funds per Member State**

Member state	Structural and cohesion funds allocation (mill. Euro)
Austria	1.461
Bulgaria	6.853
Belgium	2.258
Czech Republic	26.692
Cyprus	640
Denmark	613
Estonia	3.456
Finland	1.716
France	14.319
Germany	26.340
Greece	20.420
Ireland	901
Italy	28.812
Latvia	4.620
Lithuania	6.885
Luxembourg	65
Malta	855
Great Britain	10.613
The Netherlands	1.907
Poland	67.284
Portugal	21.511
Romania	19.668
Slovak Republic	11.588
Slovenia	4.205
Spain	35.517
Sweedden	1.891
Hungary	25.307

Every Member State has the obligation to prepare, according to the Community Strategic Guidelines for Cohesion, a national strategic reference framework (NSRF), which defines the chosen strategy by the respective Member State proposing the list of operational programmes to be implemented with the aid of structural funds. The European Commission further validates parts of the NSRF as well as every single operational programme. The operational programmes present the priorities of the Member States and/or their regions as well as the details regarding the programming phase. For the period 2007-2013, approximately 450 operational programmes have been

adopted by the European Commission. The economic and social partners, as well as civil society actively take part in the programming and management of the operational programmes.

In Romania, the background for elaborating the NSRF 2007-2013 has been ensured by the National Development Plan 2007-2013, approved by the Romanian Government in december 2005. Even though the NSRF makes use of and synthesizes the main issues included in the analysis and strategy of the NDP, they are not taken as such, but restructured according to the 3 priorities and the 11 lines of action (Community Strategic Guidelines).

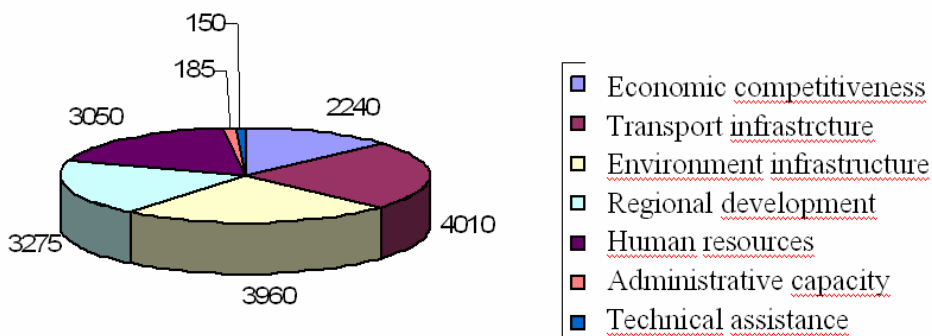
The NSRF has established **4 thematic priorities**:

1. Developing basic infrastructure according to European standards;
2. Improving long-term competitiveness of the Romanian economy;
3. Development and more efficient use of the human capital;
4. Building a more efficient administrative capacity.

**A territorial priority** has been also identified, which aims at *promoting a balanced development of the entire territory*, by creating the background for the development of the regions lagging behind and by taking advantage of the regional development potential.

As regards the financial allocation on sectors of the NSRF 2007-2013, these are shown in Figure 1.

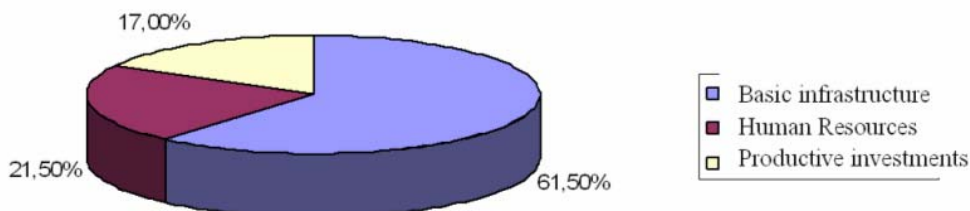
**Figure 1 - Financial allocation on sectors of the NSRF 2007-2013 (mill. euro)**



Regrouping these fields on 3 broader categories - **basic infrastructure, human resources and productive investments**, there can be

identified the following breakdown of structural and cohesion funds allocation (Figure 2).

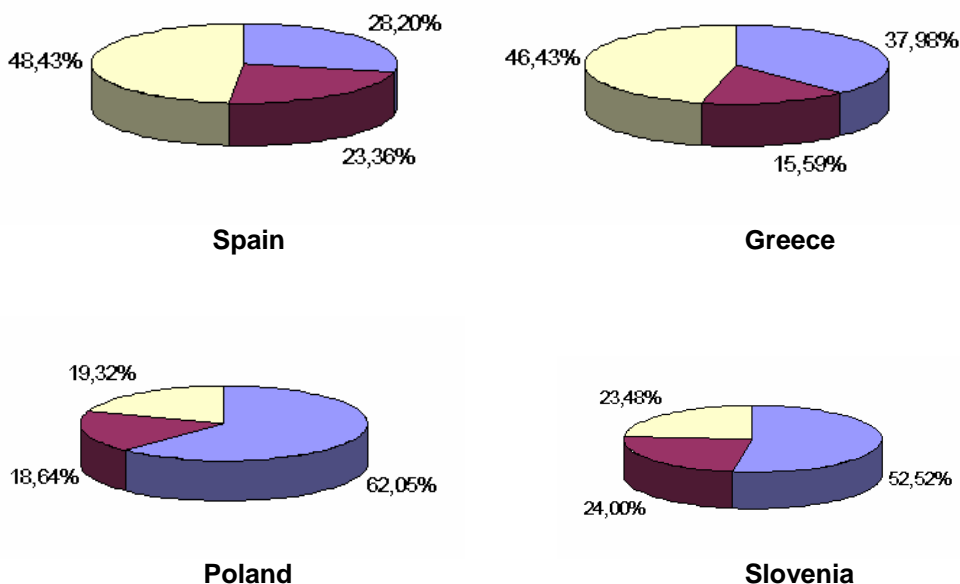
**Figure 2 - Financial allocation on main fields (%)**



Taking into account the same structure for distribution, the situation differs among Member States.

The following figure shows the cases of some “old” and “new” Member States (Figure 3).

**Figure 3 - Financial allocation on main fields in some “old” and “new” Member States (%)**



Two main trends can be distinguished:

1. in “old” Member States there is a high weight of funds allocated to productive investments in the total allocation of structural and cohesion funds. In the majority of these states, this kind of investments overpass the ones in basic infrastructure;

2. In “new” Member States, Romania herewith included, the largest share of funds is allocated to investments in infrastructure.

We can not, however, speak about a model of optimum allocation of financial resources from structural and cohesion funds just because this structure and, consequently, their absorption, are much influenced by the national specific factors, which have been taken into account when drawing the NSRF and the operational programmes.

**The concept of *absorption capacity***

The issue of ***absorption capacity*** is receiving increased attention from policy makers at EC level as well as from policy makers at national levels. Efficiency and minimizing the risks of shortfalls must be the decisive argument in choosing options for the management and implementation of Structural Funds.

A general definition of ***absorption capacity*** is “the extent to which a member state is able to fully spend in an effective and efficient way the allocated financial resources from the Structural Funds”.

The ***absorption rate*** illustrates the absorption capacity and is defined as “the level of spending as a percentage of the total amount of Structural Funds available”. Achieving an absorption rate of 100% or close to this level means that

all funds that have been allocated to a country have been fully spent.

Throughout the EU the threat of **underspending** when implementing Structural Funds programmes is a common problem. Underspending arises from a situation where available and needed funds are not being fully used. This situation is commonly referred to as a lack of 'absorption capacity'.

In the above-mentioned context, there have been identified the drivers of and possible difficulties associated to the absorption capacity of a Member State and its regions, following the processes currently taking place in Romania.

The purpose of the paper is to identify and analyze the drivers that optimize the use of the absorption capacity of structural funds as well as the main problems that affect the absorption capacity and full use of funds in certain regions and institutional environments.

### **Main drivers of absorption capacity**

In general three main factors determine the absorption capacity at national level:

- the amount of Structural Funds allocated – taking into account the overall allocation as well as the regional and sectoral breakdown into operational programmes included in the National Reference Strategic Framework 2007-2013;
- the managerial-administrative situation at both programme and project level;
- the public and private co-financing situation according to the levels negotiated between the European Commission and the Member State.

In line with these main factors three more specific definitions of absorption capacity can be provided:

1. The **macroeconomic absorption capacity**, which can be defined and measured in terms of GDP;

2. The **managerial-administrative absorption capacity** which can be defined as the abilities and skills of central, regional and local authorities to

prepare acceptable plans, programmes, and projects in due time, to decide on programmes and projects, to arrange the co-ordination among the principal partners, to cope with the vast amount of administrative and reporting paperwork required by the Commission, and to finance and supervise implementation properly, avoiding fraud as far as possible.

3. The **financial absorption capacity**, which means the ability to co-finance EU supported programmes and projects, to plan and guarantee these national contributions in multi-annual budgets, and to collect these contributions from several partners, interested in a programme or project. While the ability to co-finance is easily to be supported at government level, the private co-financing is more problematic as private beneficiaries find it more difficult to identify the financial resources that are necessary in order to cover the amounts required by several operational programmes.

### **Bottlenecks affecting the absorption capacity of Member States and regions in the European Union**

The main obstacles and problems affecting the absorption processes in the Member States and regions that benefit from the structural funds can be classified according to the level where they occur.

At national level, the main problems affecting optimal use of absorption capacity include: lack of stability of institutional, legal and political environment for regional development in general; limited availability of national co-finance for regional development from the sectoral line ministries; unclear responsibilities for and involvement in regional development issues by sectoral line ministries; weak links between bottom-up regional development plans and top-down national development plan; annual national budgets might conflict with multi-annual planning framework for Structural Funds.

The analysis at regional level must take into account specific bottlenecks deriving from the particular institutional characteristics and regional economic specificities like: limited experience with implementing projects, in particular within a programme context; wide variety in history, background and experience of the regional intermediate bodies involved in the management of the structural funds; wide variety in the organization of the intermediate bodies (ownership structures, public versus private functions, number and functions of staff, financial situation); limited availability of skilled staff in the regions; unclear position of intermediate bodies in relation to other organizations in the field of regional development, in particular the local SME support centres/advisors within individual municipalities; expertise at regional and local level is scattered over different organizations and individuals; the degree to which regional intermediate bodies are supported by the municipalities, in particular by local politicians.

The same algorithm applies at local level where the following aspects have been identified: weak financial situation of the local beneficiaries/limited local budgets for public co-financing available; intermediate bodies of the management authorities in charge with the structural funds are not yet recognized as partners for economic development by the final beneficiaries; lack of experience with regional development thinking within municipalities ("think local, act local" instead of "think regional, act local"); focus on projects with direct, visible, local, short term impact rather than projects with indirect, less visible, regional and medium term impact; lack of local private co-financing possibilities, lack of risk capital; lack of banking products and services dedicated to cover the amount of private co-financing necessary for the projects budgets.

The following issues should be also taken into account and properly managed in the attempt of maximizing

structural funds absorption: managing authorities often do not recognize their role in implementation needs to be an active one, not a passive one; there is a cultural resistance to delegation of both responsibilities and rights/powers; avoidance of 'blame' leads to avoidance of taking decisions; fear of failure results in no risk-taking and so no risk management; lack of experience and lack of confidence builds into a reluctance to seek help; lack of partnership culture (little understanding of shared objectives), too much focus on differences and non-existent or weakly developed partnership structures; pre-Accession 'hangover' – many of the proposed implementation processes are rooted unnecessarily and unhelpfully in the pre-accession thinking and are detrimental to effective Structural Funds delivery.

#### **Structural Funds absorption in Romania – some recommendations**

Romania finds itself at the beginning of the second year of the programming interval with almost no money spent from the structural funds.

One could assess that the main elements determining this situation include:

- the delays in elaborating the operational programme by the management authorities from various ministries and in incorporating the feedback from the European Commission; these delays have been mainly due to the persistence of the approach used for the implementation of the pre-accession instruments for which the strategic planning has been designed, to a large extent, by the European Commission, not by the Romanian Government;

- the delays in building a functional network of intermediate bodies and regional units in order to ensure the proper implementation of projects at grass-root level;

- the weak project management culture for both the public and private bodies;

- the weak involvement of public authorities in capacity building for potential beneficiaries;

-the reticence of certain beneficiaries vis-à-vis the low level of pre-financing offered by the structural funds and the high level of required co-financing;

- delays in elaborating the list of eligible costs and the payment and reimbursement procedures;

- certain misunderstandings between the existing and the new bodies involved in the management of the structural funds and an insufficient level of training and qualification for the staff of certain intermediate bodies.

Fortunately, for the few axes for which calls for proposals have been launched, there has been a satisfactory number and quality level of applications so there is a good starting point to envisage a good level of absorption for the remaining years of the programming interval.

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