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## STRUCTURAL FUND ABSORPTION: A NEW CHALLENGE FOR ROMANIA?

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### Abstract

*Many European countries, especially during the early post-accession years, have faced difficulties in absorbing the structural funds from the EU budget, the most cited reasons being generated by the lack of a coherent long-term vision of the authorities, insufficient resources to co-finance projects, low administrative capacity at central and local levels, lack of inter-institutional coordination, failures of public-private partnerships, insufficiently skilled human resources, causes which can undoubtedly be noticed also in the case of Romania. By a strategic approach starting from the HEROM econometric model (the Romanian version of the HERMIN model) the study tries to assess the macroeconomic effects of structural funds on foreign trade in cases of different absorption rates, finding that these funds have a stronger impact on export growth as compared to that of imports. The EU structural funds absorption represents an opportunity to sustain economic growth and to reduce the development gap which, under the circumstances of global recession, is becoming a new challenge for Romania.*

**Keywords:** European integration, economic and social cohesion policy, structural funds, absorption capacity, economic development, econometric models

**JEL Classification:** C53, F15, F36, F43, O19

### 1. Macroeconomic effects of the EU integration

The research concerning the effects of the European integration on sustaining the economic and social development of the member countries, on the process of convergence and on reducing disparities (catching up) between countries is an area of special interest, both for academics and practitioners.

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Literature abounds in studies about the integration effects on the economic growth (among them Balassa, 1975 and Baldwin, 1989, 1992, 1996) and prospective estimates have become increasingly complex. For this purpose, in the beginning, general equilibrium models were used, subsequently the researches were expanded by incorporating factors of imperfect competition (Smith and Venables, 1988) and by being supplemented with retrospective analyses on economic growth performance of the member countries. By the 1990's, special attention was given to researches on the integration effects on trade and not on the income or economic growth. This theoretical and analytical priority has been influenced, in particular, by Viner's studies (1950) on the creation and diversion of trade, the intensification of trade flows between nations being most easily observable.

The development through trade was a thesis of several United Nations "decades of development" that considers foreign trade, *ipso facto*, as one of the most important factors of economic growth. Subsequently, it has been a change in terms of research on integration effects, in the sense that this process represents a way to achieve objectives such as increasing income, rise in population consumption, and improvement of the quality of life. In this new context, of integration and trade as leading factors of economic growth, measured according to appropriate outcome indicators, the WorldScan models for CEECs (Central and Eastern Europe Countries) assessed the effects of changes in tariffs, internal market and migration on consumption, GDP and terms of trade. Other effects of integration arise from the impact on member countries of the Common Agricultural Policy changes and from joining the Monetary Union. It is considered that they have a greater degree of uncertainty due to their political dimension, being more difficult to predict.

The above-mentioned models take into account the possibility of accessing the structural funds by the CEECs which are UE Member States on the basis of several scenarios, which adopt different assumptions on the rules of allocation and access to these funds. According to the estimates resulted by using these models for the period 2004-2020, the contribution of structural funds to the economic growth in CEECs would be 0.1-0.2 percentage points per year.

Lejour and Nahuis (2004) believe that the EU enlargement brings more benefits to the new Member States and only a modest improvement of welfare for the older EU Member States. This conclusion is shared by many experts. On the other hand, we cannot overlook that, in an integrated economic group of countries with different levels of economic and social development, those which are more advanced benefit to a greater extent from the integration effects as compared to the less developed ones. This latter view takes into consideration the positive effects of repatriated profits generated by the large volume of foreign direct investments in CEE countries, by the earnings in the developed countries on the account of foreign labour, which is paid less as compared to the local workers, by the opportunities for increased production in these countries as a result of the opening of new markets in the new Member States, etc.

In the work of Brown *et al.* (1997), it is estimated that the CEECs are gaining through integration 3.9-7.3 percent of welfare growth, while in the former member states the gain would be only 0.1 percent. Similar results were found by the research of Baldwin, Francois and Porter (1997), showing a gain through integration of 1.5 percent in terms

of real income for CEECs and a much more modest increase for older EU Member States. Subsequent estimates (Brussa, 2001) regarding the effects of CEECs integration into the EU have reached over 4-9 percent of GDP growth in these countries and only around 0.1 percent for other member countries. If these relative numbers would be assessed in absolute terms, this could indicate greater values (earnings) for the largest older EU members, which would lead to a change in conclusion regarding the biggest beneficiaries of the European integration.

Research undertaken by Lejour and Nahuis (2004) concerning the effects of EU enlargement upon the economies of the member countries, unlike previous studies, tries to cover a wider range of effects, as the authors find that the custom union and removing bilateral tariffs, the accession to the internal market and the free movement of labour are combining with the effects generated by the structural funds. Thus, it concludes that the GDP per capita in the new member countries will record an increase of more than 8 percent in the long run. If compared with the EU-15, the average annual growth of consumption per capita in the CEECs would be 5 percent, a relatively high pace, but which will not ensure however, in a short period of time, the closing of the gap separating them from the developed countries of the European Union.

In order to reach the average level of the EU-15 in a relatively short period of time, the average annual growth of the new member countries should be over 5 percent, considering that the EU-15 would record annual growth rates of 2-2.5 percent. If the annual differences of GDP growth between the CEECs and the EU-15 will remain around 1.5-2.5 percentage points, as it has been until now, over 80 years would be needed for the CEE countries to reach the level of the EU-15 average. In a situation where, for 20 years, the CEECs would record an annual growth average of at least 7 percent, it would be possible to achieve in the new member countries a GDP per capita representing 50 percent of the average level of the EU-15. But an annual growth of 7 percent requires a great effort from the CEECs in the following directions: the effective integration into the EU market and policies; the promotion of radical reforms in economic and social fields; the expansion of modern technologies transfers, through trade and FDI; the increase in labour mobility, including the highly skilled; the administrative and institutional reform; the creation of a proactive civil society, with appropriate mechanisms of coordination.

## **2. The policy of economic and social cohesion within the European Union**

For the programming period 2007-2013, the policy of economic and social cohesion of the EU has a budget of EUR 308 billion (about 35 percent of the total EU budget), with 3 major objectives:

- Convergence, an objective supported by EUR 251 billion (81.5 percent of structural funds), aimed at regions of the EU Member States with a GDP per capita less than 75 percent of the Community average and at regions falling into the so-called "statistical effect" of changing the EU average following the accession of new members;

### *Structural Fund Absorption: A New Challenge for Romania?*

- Regional Competitiveness and Employment objective, for which EUR 49 billion (16 percent of structural funds) is allocated, aimed at regions that are not eligible under the convergence objective;
- European Territorial Cooperation, an objective supported by EUR 8 billion (2.5 percent of structural funds), aimed at transnational cooperation, cross-border and inter-regional cooperation.

The programming budget is supported by structural instruments (European Regional Development Fund, European Social Fund and Cohesion Fund) and two complementary actions (European Fund for Agriculture and Rural Development and the European Fisheries Fund). Programming and implementation of structural funds are done through the Operational Programs (OP), documents prepared by the Member States and adopted by the European Commission as part of the National Strategic Reference Framework stemming from the National Development Plan.

It is worth mentioning that financial resources allocated to support the cohesion policy for 2007-2013 have been established, after tough negotiations, at a maximum amount of 0.45 percent of GDP achieved in the EU. In this context, Spain, Portugal, Greece, and many of the new entrants have requested an increase in spending over this ceiling, considered insufficient for financing needs for achieving the objectives of cohesion policy, but have encountered resistance of the net contributor countries (Germany, the United Kingdom, Sweden, Austria, and the Netherlands). Also, the allocation methodology introduced the concept of *absorption capacity*, which restricts the transfer of EU funds to maximum 4 percent of the respective country's GDP. A collateral effect of establishing in this way the absorption capacity was emphasized by the low intensity of aid per capita for the poorest countries, contrary to the philosophy of the allocation methodology, which implies supporting them with priority. In compensation, at least in part, to facilitate the absorption of funds by the new member countries, the maximum rate of co-financing from EU structural funds increased from 80 percent to 85 percent and the rule of financing "n +2" became "n +3" from 2007 to 2010, and certain eligibility criteria were relaxed.

The purpose of the cohesion policy, implicitly of structural funds implementation, lies in the transformation and upgrading of the economy of regions and EU countries lagging behind in their preparation for the competition in the single market and in the Euro Area, respectively. It is obvious that, under the circumstances of budget constraints, which will probably increase during the period 2009-2013 as a result of the effects of international financial crisis, the growing selectivity in the allocation of resources, still limited, both on the formation side and the utilization side, could endanger the achievement of the objectives of economic and social cohesion, potentially affecting also Romania. Moreover, the threat of global recession in 2009 could bring specific negative effects on the Romanian economy. Major risks are arising from the excessive deficit procedure that EU could launch against Romania following the budget deficit registered in 2008 (more than 5% of GDP), which means the limitation of structural fund national co-financing and their reduction in amount and absorption.

Concerning the new Member States, during the transition to a market economy in the 1990s, which left many unresolved institutional and administrative-territorial issues, it

should be noted that only the EU accession has brought regional policy on their priorities agenda. The debate covering "complementarity or conflict" in the EU post-enlargement era gave birth to a new paradigm: *the national regional policy*. Compared with the classical meaning of the regional policy concept (based on theories of industrial location, with key factors such as regional attributes, production costs, availability of labour, etc.), the actual concept is based on modern theories of knowledge at the regional level, with other key factors (regional capabilities, innovative environment, clusters, networks, etc.), this new approach influencing also the allocation of structural funds. More emphasis on regional competitiveness (rather than on regional balance) and on efficiency increase (rather than on productivity improvements) shall be laid by shifts from individual spatial targets to the regional objectives, and to coordinate policies at the national and regional levels, between centre and territory as well (Bachtler J., Wishlade F., D. Yuill, 2003).

Some authors think that structural fund transfers are the result of political negotiations, as the poorer regions and the new Member Countries receive financial aid in exchange for remaining into the single market, which is giving, in fact, more scale advantages to the large and influent countries (Boldrin M., F. Canova, 2000). Without generalizing the validity of such a view, it should be noted that in the context of an enlarged EU, which significantly increases the territorial development gap - implicitly the number and the needs of structural fund beneficiaries, the reduction in aid intensity will indeed make arguably any statement regarding its real contribution to the achievement of cohesion objective, not even mentioning the methodological difficulties for the assessment of the effects of projects financed by the EU.

The possible economic effects of structural funds, presented in various impact studies based on econometric models, reveal quite an "ambiguous" picture in the sense that "some studies report a positive impact, others a non-significant one or even a negative one" (Deardorff, 2004). According to certain studies, the structural funds could boost GDP growth in the CEE countries by 0.7 percent annually, while some econometric models do not indicate more than 0.1 percent.

Among the causes for which structural funds cannot be effectively utilized by the beneficiary countries in order to reduce disparities and achieve convergence are:

- An important part of structural funds is allocated, in fact, to the rich countries of the EU;
- Concentration of funds for economic growth under the impact generated by internal taxation of various countries;
- Failures of government policies that lead to improper spending of funds and unjustified personal or group earnings.

Thus, a high efficiency of structural funds is conditioned by the quality of governance in general and of public administration institutions in particular. But their inability to remove or minimize corruption makes the economic and social benefits obtained from the use of structural funds be rather modest.

On the other hand, structural funds are viewed as a sign of solidarity, in the sense that the rich countries help the poorest ones. European leaders are defending their cohesion policy by arguing that, in the poor regions the GDP per capita increased

from 54 percent of the EU average in 1987 to 61 percent of the average a decade later. They also states that gap recovering from countries lagging behind, such as Ireland, was even faster, the latter exceeding the EU average. However, the fact that the poor countries have recovered more quickly than the poor regions contradicts the fact that over 80 percent of the EU aid is sent to regions rather than countries.

We point out that at the end of the programming period 2000-2006 a certain reduction in the gap between countries in GDP per capita was recorded, but also growing disparities within member countries and among regions, the cohesion policy and structural funds failing to eliminate unbalanced regional development. On the other hand, the EU Treaty signed in Lisbon in December 2007 refers only to two aspects of cohesion (economic, seen as reducing disparities measured by GDP at the regional level, and social, seen as reducing inequalities between individuals in regions) focusing, as the most important targets, on education and employment. It is obvious that the process of economic and social cohesion does not evolve in a similar manner for all the territories and for all the individuals, the spatial development process having a high degree of concentration, while population and activities remain polarized in certain areas.

In conclusion, in the future, the regional policies need to be developed taking into account that the cohesion relates to the recovery of the development gap, and the implementation of these policies, including structural funds, will have to rely on multi-level governance. Taking into consideration that structural interventions are generally on short term and medium term, while on long-term the market itself should ensure an increase in the general welfare, implicitly a reduction of disparities, including the territorial ones, the real challenge for the EU is in our view to prove the resilience of the European architecture, which is facing global economic competition, deep crisis on the international financial markets, threats of recession, uncertainties on the energy and raw material world markets.

### **3. Problems regarding the EU structural funds absorption capacity**

A review of the literature regarding the absorption of the EU structural funds reveals a lack of adequate conceptual framework, while the topic of better ways to manage these funds is less addressed. As the explanation could not be related to the lack of interest in studying such a problem, the reasons are essentially linked to its relative novelty, to the difficulties in assessing the impact of structural funds on the EU convergence in the long run, to the construction of appropriate indicators, including ones for the measurement of the absorption capacity.

It is obvious that if structural funds are not fully absorbed, their justification itself can be raised, so no regions, no Member States and nor the European Commission have any interest in a low rate of absorption. A solution in such a case would be the reallocation of funds among structural measures, priorities, or even among programs. However, before reaching such an alternative, a series of effective management solutions should be implemented and, to that end, it is necessary to define unequivocally what they mean for the absorption capacity and its determinants.

Very often, the absorption capacity is understood as the extent to which a Member State is able to spend the financial resources allocated from the Structural Funds in an effective and efficient manner, having three connotations:

- macroeconomic absorption capacity, defined and measured in terms of GDP (limited, as mentioned above, to 4 percent);
- financial absorption capacity, defined as the ability to co-finance the programs and projects supported by the EU, to plan and guarantee these national contributions in multi-annual budgets, and to collect contributions from the partners involved in various programs and projects;
- administrative capacity, defined as the ability and qualifications of central and local authorities to prepare programs and appropriate and timely projects, to decide on them, to ensure coordination of partners involved, to comply with administrative and reporting requirements, to fund and monitor the implementation of programs and projects, to avoid irregularities.

The performance, namely how the structural funds were used effectively and efficiently, is considered an *output variable*, which can be evaluated ex-post, at the end of the programming period. For the newly entered countries, a theoretical pre-assessment of performance is possible, depending on the results obtained during the use of the pre-accession funds. In order to create the prerequisites of an effective and efficient management of structural funds, and the performance thereof, a great attention should be paid to their programming (structure, human resources, systems and tools) as an *input variable*, which depends on the requirements arising from the EU rules on the matter (Boeckhout S., L. Boot, etc., 2002).

It is worth mentioning that the absorption of structural funds is a process that is manifest in various stages:

- Structural Funds programming architecture (the number of priorities, their content, the management authorities, intermediate bodies and final beneficiaries);
- The level of commitment (funds allotted to projects by the management authorities);
- Payments to beneficiaries in various stages of implementation.

Taking into account the above-mentioned absorption capacity it is believed that it is influenced mainly by the administrative-managerial and co-financing capabilities. The relationship between the absorption capacity of structural funds and the regional economic situation is a paradoxical one, as practice demonstrates that the most disadvantaged regions are experiencing also the greatest difficulties in the absorption of these funds. At the same time, they are the regions that need, theoretically and practically, the largest financial support for restructuring their economies. The main explanation for this paradox lies in two factors: on the one hand, the difficulties of regional authorities due to lack of experience and qualifications, which are added to those arising from bureaucratic procedures and slowness of the EU decision-making process under the circumstances of unclear sequential procedures for programming at the central level and, especially, at regional level. On the other hand, the ability to harmonize the co-financing depends on the willingness of various partners to provide funds, as well as on the technical and institutional abilities to collect contributions, as

often the local authorities are reticent regarding the horizontal collection because of external interference and of potential control involved.

There is a consensus upon the fact that the problems of absorption depend heavily on the institutional factors, both of EU and national structures. At the EU level, the institutional factors are related primarily to the European Commission: the transparency of fund allocation process, the consistency of using various funds and other factors such as bureaucratic administration, whose organizational capacity can be affected by lack of vertical communication and of horizontal coordination. At the national level, institutional factors are related to the real structure of the economy, the administrative capacity, the political system (federal versus central), and the economic policies. Therefore, even under the conditions of similar fund transfers (as absolute and/or relative size), it is expected that the issues of absorption differ from country to country. Other important determinants of the absorption capacity refer to the programming and institutional building and to the administrative capacity development during the pre-accession period. In accordance with the Commission's recommendations and best practices of the EU countries, a *golden rule* became obvious, according to which the smaller the number of institutions involved at different levels of management and programs (sectoral and regional) in the new member countries is, the greater the possibility of higher rates of structural funds absorption is (A. Horvath, 2004).

It was found that the Regional Development Agencies have a particular role in the implementation of structural funds, especially at project level and the quality of their work positively affect the absorption rate. On the other hand, the Regional Development Agencies vary significantly by country. In countries such as Ireland, Portugal and Greece - characterized by strong central administration - with a key role in the decision on allocation and monitoring of structural funds - territorial agencies play a minor role. In Sweden, France and the UK - with a lower degree of concentration of the administrative system - the main powers of implementation of structural funds fall back on regional offices of national administration. In countries such as Germany, Austria and Belgium - federal states, with a decentralized administrative system - the implementation of structural funds falls wholly or partly on the regional authorities. Such a system exists also in non-federal countries like Denmark, Finland and the Netherlands, which have a higher degree of regional autonomy.

The various economic theories confer to the structural funds also an attribute of shock-effect on the revenue of a country or region, therefore affecting the saving-investment behaviour of the actors in the private and public sector, in the sense of reducing the internal effort motivation for the financing of development. If structural funds have not severely used constraints, it is believed that their impact on capital accumulation and economic growth may be lower than expected. In the European context, decisions may be affected also by the fact that the beneficiary countries, knowing in advance what funds are received from the EU budget for the next six years, prefer to delay the structural adjustments; for example, the eligibility criteria of Objective 1 (regions with a GDP per capita below 75 percent of the EU average) may reduce the motivation to accelerate economic growth, in order to benefit from structural funds for a longer period of time. Another example of the practice of some countries is that governments are neglecting the maintenance of the existing capital

stock in order to meet the requirements of co-financing Operational Programs projects, which reduces the potential growth, omitting also the fact that, once projects completed, allocations from the public funding continued.

The experience of countries that have joined more or less recently the European Union reveals the contribution of structural funds to the improvement of the economic and social cohesion of the Member States, if not decisively, at least by determining a positive trend in this regard. Many European countries, especially during the first years after the accession, have faced difficulties in the transfer of funds available from the EU, the most cited reasons being generated by the lack of a coherent long-term vision of the authorities, insufficient resources to co-finance projects, low administrative capacity at central and local levels, lack of inter-institutional coordination, failures of public-private partnerships, insufficiently skilled human resources, causes which are expected, without doubt, also in the case of Romania.

#### 4. The absorption of structural funds by Romania in the early post-accession years

We are pointing out that the structural funds (including the cohesion funds) allocated to Romania from the EU budget for the programming period 2007-2013 amount to EUR 19.2 billion, plus national co-financing (state budget, local budgets and private sector) of around EUR 9 billion. Structural funds are implemented through five Sectoral Operational Programs (SOP, respectively, for Transports EUR 4.5 billion, for Development of human resources EUR 3.4 billion, for Increasing economic competitiveness EUR 2.5 billion, for Development of administrative capacity EUR 208 million; for Environment EUR 4.5 billion), one program for regional development (ROP, respectively, EUR 3.7 billion) and one technical assistance program (EUR 170 million).

Table 1

##### European funds allocated to Romania in 2007 and their absorption rate

	Allocated (EUR bn)	Drawn (EUR bn)	Absorption rate (%)
<b>Total structural and cohesion funds</b>	<b>1.28</b>	<b>0.42</b>	<b>32.7</b>
- European Fund for Regional Development	0.60	0.18	30.1
- Cohesion Fund	0.44	0.16	36.8
- European Social Fund	0.23	0.07	31.6
<b>Total funds for agriculture and rural development</b>	<b>0.76</b>	<b>0.02</b>	<b>3.0</b>
- European Fund for Agriculture and Rural Development	0.74	0.01	1.0
- European Fund for Fishery	0.02	0.02	100.0
<b>TOTAL</b>	<b>2.03</b>	<b>0.44</b>	<b>21.7</b>

Source: Isărescu M., *Attraction of European Funds in Romania* (in Romanian language), NBR, 14 March 2008 (based on data provided by the Ministry of Economy and Finance).

Out of the total structural and cohesion funds allocated to Romania, our country counted on EUR 1.28 billion in 2007. According to a study presented by M. Isărescu (the Governor of the National Bank of Romania) in March 2008, based on data provided by the Ministry of Economy and Finance, with only EUR 0.42 billion drawn from the EU budget, the absorption rate of these funds was only for 32.7 percent (see Table 1). As noted in the NBR study, the primary cause of the low absorption rate of structural funds is linked to the delays in program elaboration at the national level, but also in decisions concerning the budget at the EU level, which made the 7 operational programs to be sent to Brussels only in June 2007, six months after the accession of Romania to the European Union.

Under the circumstances of no information concerning the concrete use of the EUR 420 million drawn from the structural and cohesion funds, namely on what specific programs, axes or areas of intervention the money have been spent, there are big doubts about the real rate of absorption. Moreover, the available public information does not show the start of the funding (with disbursement from the EU) of any project within the operational programs. On the other hand, if along with the structural and cohesion funds we take into account the funds for agriculture and rural development allocated to Romania in 2007, amounting to EUR 0.76 billion, as seen in Table 1, the absorption rate of total European funds was only 21.7 percent, as compared to about 42 percent carried out by Hungary, Poland, Slovakia or the Czech Republic.

Furthermore, if for these countries, which joined the EU in 2004, there is a real absorption rate, to be relevant in the case of Romania it needs to be calculated in 2010, when, according to the "n + 3" rule, one would know exactly the funds spent and reimbursed from the EU budget during 2007-2009. It is worth mentioning that the procedures for access to structural funds from the EU budget is very rigid, according to the "n +3" rule, the projects requiring to be contracted, completed, implemented and disbursed within maximum 3 years after the funding approval.

Regardless of the relativity of data, it is obvious that in 2007 Romania recorded a negative net position towards the EU budget (representing 0.36 percent of the GDP), being in the paradoxical situation of a net contributor, despite the fact that among the EU-27 member countries it is in the penultimate position in terms of economic development level (as GDP per capita), in theory benefiting of greater funds to support the process of convergence and gap recovery.

A significant improvement of this situation is not to be expected in 2008 either: according to our estimation, even the government target concerning the absorption rate of EU funds would be around only 40 percent (of the total EU funds allocated amounting to EUR 2.9 billion over EUR 1.2 billion are likely to be absorbed, as compared to EUR 1.4 billion contribution to the EU budget) predictable not to be achieved, so that Romania will be for the second year in the position of net contributor.

In September 2008, the European Commissioner for Regional Development stated that the payment of structural funds for Romania may not start until the government sends to Brussels a report of conformity regarding the management system of these funds, certificated by the national audit authorities. In the first 8 months of 2008, Romania was granted in advance payments of around EUR 1 billion, but to receive the next instalments and begin effectively the disbursements, the audit reports on the

implementation of operational programs proposed by the Romanian government must be approved by the EU. On the other hand, from the statements of Ministry of Finance officials it does not result that payments would have been made for any project from the structural funds received in advance, at least by September 2008.

We consider that Romania's inability to use the EU funds is endemic, even if it can be explained by the action of various factors, including bottlenecks in public administration under the circumstances of general and local elections in 2008. The fact that our country fails to attract European funds in the early post-accession years, at least to the same extent to the national contribution at the community budget, registering a net expenditure as a EU member is a situation not only paradoxical, but with dramatic effects on the horizon of development gap recovery and of real convergence with the EU countries.

We think that debating the issue of European fund absorption by Romania is somehow confusing, the main reason being linked to the lack of transparency of the central government, particularly at the level of operational program management (the line ministries), unwilling to admit the existing vulnerabilities in this regard and to identify possible remedies. Instead of an analytical image, it presents an incomplete picture of European fund absorption, pointing out only positive aspects, which also makes a purely scientific approach difficult.

It is important to note that during the phase of project implementation, the absorption of structural funds may be influenced by the vulnerabilities arising from the macroeconomic framework of Romania, both internally and externally. Given the possible effects of the international financial crisis on economic growth, a possible abrupt adjustment of exchange rates and maintaining a high rate of inflation during the period 2009-2012 are expected to create pressures on the enforcement of contracts (concluded in local currency) and the cost of construction works. There should also be taken into account the developments in the labour market in the construction sector, which already faces a labour crisis, affecting the wages of workers and technicians in the sector and also the deadlines of constructions.

A major vulnerability that could affect Romania's absorption rate of European funds is the rigidity of the banking system as regards the loans for co-financing the projects. In the context of strengthening the lending conditions imposed by the NBR, including mitigating the effects of international financial crisis, interests and commissions charged by commercial banks rose, and applicants are asked to deposit a percentage of the amount financed (up to 20-25 percent), as cash collateral, which remains locked until the loan receives the bank approval, which means a delay of several months.

## **5. The stage of Operational Program implementation and factors leading to the increase in structural fund absorption**

On the basis of the information published by the Ministry of Economy and Finance at the end of June 2008 we consider that out of the total of 1297 projects submitted within the seven existing Operational Programs, a number of 281 projects were

approved, with a value of around EUR 2.5 billion, of which EUR 1.8 billion accounting for EU funds. Out of 281 approved projects only 23 financing contracts were concluded with the beneficiaries, with a total value of around EUR 204 million, of which the EU funds amounted to EUR 180 million. Thus, indirectly, after a year and a half from Romania's accession to the EU it is not confirmed that it would have been disbursed (effectively absorbed) even one EUR from the structural and cohesion funds, for a specific project.

Among all the Operational Programs, the ROP is considered as best articulated and advanced. However, it is worth mentioning that the so-called advance of the ROP, at least concerning the submitted projects, is not due to any merit of the management authorities, but rather to the fact that a number of projects from the reserve of pre-accession program "PHARE Economic and Social Cohesion 2003, and 2004-2006, respectively", adapted to the requirements of the new Applicant Guides under the technical assistance of the former Ministry of European Integration were transferred to the ROP.

The Regional Operational Program is structured by five Priority Axes and fifteen major areas of intervention, namely financing lines (making abstraction of Priority Axis 6, namely Technical Assistance), having a budget of EUR 4.5 billion over the programming period 2007-2013 (of which EUR 3.7 billion contribution of the EU). This program, having the Ministry of Development, Public Works and Housing (MDPWH) as Management Authority and eight regional development agencies as intermediary bodies, was approved and became operational on July 12, 2007.

By the end of September 2008, the Management Authority approved payments of EUR 2.2 million, out of which the Certification Authority certificated payments of only EUR 0.7 million, i.e. an absorption rate close to zero. In the absence of data on funds effectively disbursed from the structural EU funds, the main criterion for assessing the progress of any operational program implementation, including the ROP, is the number of projects submitted. It should be noted that from the submission of a project to its approval, signing of financing contracts and starting the disburse of the first expenditures from the EU (effective absorption of structural funds) a long road has to be passed by the process of assessment (compliance, eligibility, technical and financial), including strategic assessment, which may take more than one year.

It is worth mentioning that, until the end of September 2008, in the major areas of intervention of ROP 1112 projects had been submitted, of which 733 projects were in various stages of assessment, selection and contracting, cumulating a total value of more than EUR 2 billion. The largest part of it focuses on the Priority Axis 2 (Improving the regional and local transport infrastructure), namely EUR 1507 million, almost double as compared to EUR 876.7 million available for this axis for the entire programming period in 2007-2013. That is why the submission of further projects for this axis was suspended in October 16, 2008, yet for two regions.

A number of 66 projects were in various stages of pre-contracting, 8 being under internal assessing by Management Authority, 3 in the stage of pre-contracting visit, and 55 in the stage of filing the technical project. At the end of September 2008, on all axes (except Priority Axis 6 - Technical Assistance), only 9 contracts were concluded, all belonging to the Priority Axis 2, amounting to 535.1 million lei (EUR 163.2 million),

of which 435.6 million lei (EUR 132.8 million) grants from the EU structural funds, which would represent almost 90% of the amount scheduled for this axis through the Framework Document of ROP Implementation for the years 2007 and 2008.

As follows, ROP finds itself in a paradoxical situation in which, although virtually no disburse has begun for any project, the submission of the other ones has been cancelled, which means not only a blockage of funds (becoming evident also their under-sizing), but in fact, proving the inability of the administrative management to keep pace with the needs of developing the regional transport infrastructure, and the absorption of available structural funds, at least so far. Under these circumstances, the MDPWH announced that applications for funding for eligible projects exceeding the regional financial allocation would be included in a list of reserves, and that the assessment process for them could be unlocked only if - and when - additional amounts would be supplemented within the area of intervention for the region in question.

In conclusion, we appreciate that, to increase the European fund absorption capacity, the Romanian authorities should activate a number of specific factors, including:

- Strengthening the administrative capacity, also by preparing qualified personnel and avoiding fluctuation of employees in the system, both at the level of line ministries and the level of regional development agencies;
- Greater transparency by providing exhaustive information and elimination of excessive bureaucracy (which is generating corruption) from the system of financing project approval, but also by providing comprehensive information of public interest;
- Stabilization of the rules governing the access to structural funds, particularly the requirements of the Applicant Guidelines, avoiding further corrections that delay the approval of eligible projects;
- Completion of audit reports on the implementation of Operational Programs by the Management Authorities, so that they can be approved by the EU by the end of 2008 - conditionality for starting the reimbursements;
- The regulation of contractual relations among the different institutions at the central and local levels, between them and the consulting firms, namely the project beneficiaries, so that deficiencies in contract matters should no longer affect the deadlines for approving the funding, implicitly the rate of structural fund absorption;
- Establish performance criteria for consultancy firms agreed by the central Management Authority for the preparation of feasibility studies (including technical, if necessary) with severe penalties in cases of noncompliance with commitments assumed (quality and deadlines);
- Reducing the duration of the evaluation, selection and contracting procedures by increasing the quality, both for funding applications (providing all documentation required), and for Management Authorities and intermediary bodies;
- The inclusion both in the central and local budgets of the amounts planned by the central/local government for co-financing projects from the structural funds, complying with the conditions imposed by the state aid schemes;
- Analysis at the level of the Ministry of Economy and Finance of all applications for eligible project funding, which, due to the fact that they exceeded the regional financial

allocation they have been included in the reserve list, trying to find other sources for financing the projects of high national or regional interest.

## **6. The macroeconomic impact of the structural funds. A strategic approach**

The effectiveness of Romania's integration into the EU implies attraction of net benefits that the European single market offers for the economy of Romania under the circumstances of a member country status, taking into account the commitments and obligations on short, medium and long term. In the new context of integration, the issue of increasing the absorption capacity of structural funds over the period 2008-2013 is a primary requirement for increasing economic competitiveness and sustainable development of Romania.

The lesson of the new EU member states showed that during the first years of integration a lower absorption capacity of EU structural funds is registered, due to lack of experience and difficulties in developing eligible projects and non-compliance with Community requirements in terms of procedures and financing. Romania is no exception in this regard. Moreover, one should note that in 2007 and 2008, the first years of integration, the absorption capacity of Romania was much lower as compared to the new EU member countries belonging to the 2004 accession wave.

In order to assess the growth potential offered by the structural funds, on the one hand, and to mobilize efforts to access effectively the financial instruments, on the other hand, Ciupagea C. and Voinescu R. (2007) tried to assess, quantitatively and qualitatively, the macroeconomic impact of the Structural Funds 2007-2013, on the basis of the HERMIN-type model for the Romanian economy – the HEROM model (Ciupagea C. 2000). This type of model was used in practically all the EU member countries.

It is worth mentioning that the above-mentioned HEROM model takes into consideration two basic scenarios, assuming Romania's economic growth "with structural funds" and "without structural funds". The scenario "without structural funds" does not take into account the EU structural funds provided to Romania during 2007-2013, being limited only to the pre-accession funds. The second scenario "with structural funds" is based on the assumption that the structural funds, scheduled in the National Development Plan 2007-2013, are absorbed at a rate of 100%. The HEROM model adopted also the assumption that after 2013 the structural funds will be reduced to zero, which will cause a "shock" to the Romanian economy, with adverse effects over a period of several years.

Ciupagea and Voinescu conclude that the annual economic growth average would be higher by 2 percentage points in the case of the scenario "with structural funds" as compared to the scenario "without structural funds" during the period 2007-2013, but they drew attention to some phenomena that can negatively affect these expectations. In both scenarios, especially in the one with structural funds absorption, the demand for labour in the sectors of services and the processing industry registered higher rates of increase as compared to the supply of labour force at the level of the Romanian economy, which may lead to strong constraints in certain sub-sectors as

regards Romania's development potential in the next decade. The study pointed out that, in the case of no action to increase the mobility and quality of the human factor and to reduce disparities among the regions, it is possible that the growth rates achieved by Romania are lower than those projected, due to the limitations imposed by the insufficient supply of labour, both in quantitative and qualitative terms.

According to the results of the HEROM model, as an effect of a financial injection granted by the structural funds in the Romanian economy (specified in the Reference National Strategic Framework 2007-2013), the GDP will be higher by 15-20 percent in 2013. As a consequence of the halt in structural funds financing since 2014, in the case of the scenario "with structural funds", there will be a reduction in the GDP growth over a period of 2-3 years, after which it will be resumed, so that the "differential" of annual growth rate average between these two scenarios will be reduced to less than 1 percentage point in the 2007-2020 forecast.

In conclusion, according to the final results of the model, Romania's GDP per capita in 2020 would represent 60-65 percent of the EU-27 average in the case of the scenario "without structural funds", and 75-80 percent in the case of the scenario "with structural funds".

Starting from the cited econometric model for Romania, we try to assess the macroeconomic impact of structural funds on import and export growth in Romania, as a percentage difference between the values obtained in the scenarios "with structural funds" and "without structural funds" (Table 2).

Table 2

**Difference between Romania's import and export growth rates in the scenarios "with structural funds" and "without structural funds"**

Years	Imports	Exports
2007	-0.20	0.65
2008	0.20	0.51
2009	6.18	0.29
2010	6.49	0.15
2011	8.67	0.88
2012	7.94	1.75
2013	5.66	2.34
2014	-6.96	2.64
2015	-3.96	3.53
2016	-0.85	3.53
2017	1.11	4.67
2018	1.59	6.20
2019	2.20	6.90
2020	2.44	6.74

Source: Ciupagea C., Voinescu R. *The assessment of the impact of structural funds in Romania*, Quarterly Bulletin, National Commission for Prognosis, No. 2/2007, p. 28 (in the Romanian language).

The period 2014-2016 will record negative growth differences or reductions, as a result of the halt in financing from the structural and cohesion funds. On the other

hand, it was found that the structural funds have a stronger impact on the growth of exports than on that of imports, which represents a positive phenomenon for the growth enhancement in Romania.

Presenting the HEROM model assumptions and results aims to make proposals for refining its analytical and predictive capacity in order to continue researches in this debatable area.

Undoubtedly, the HEROM model showed its usefulness as a landmark and prospective argument. It lays, in fact, at the basis of certain forecasts of the Reference National Strategic Framework agreed between Romania and the EU. But still we want to make some outlines in order to increase the analytical capacity and the predictive accuracy of the results, starting from the wish to be closer to the realities of the integration process, taking into account the experience of other countries, older and new EU members, in accessing the structural funds and also the need for a greater ability in the use of the extrapolation method.

We believe that the assumptions of the scenarios "without structural funds" (EU funds zero) and "with structural funds" (their absorption rate of 100%) are useful for emphasizing the importance of the EU financing of the economic growth of Romania. However, the lack of verisimilarity of favourable macroeconomic effects magnitude upon Romania, as a result of structural funds, must take into consideration the following:

- Neither the "without structural funds" assumption nor the "structural funds absorbed 100%" assumption is realistic or even probable with a high degree of certainty, whereas the experience of other countries has shown that the absorption rate varies from one period to another, so that the two "extreme" alternatives have not been verified in any situation;
- Starting from the previous experience of other countries, we consider that the scenarios with different degrees of absorption rates during the period 2007-2013, or with an average of the absorption rate for the entire period would rather be more adequate.

Starting from the results of the two "extreme" scenarios (full absorption of funds or non-absorption at all), we will attempt to assess the impact of EU financial assistance on imports and exports, under the circumstances when growing differences in absorption rate from one year to another are registered, in the version 1- pessimistic and version 2 - optimistic (Table 3).

After 2013, the scenarios with and without structural funds reveal the stronger impact on exports as compared to imports, but the magnitude of impact is difficult to forecast under the conditions in which it is possible to adopt other two scenarios, i.e. "with" or "without" integration into the Monetary Union. This obviously complicates the way to identify the various factors of influence and to determine their direct and forecasted impact (spillovers). In addition, the international financial crisis triggered in 2008 could have a severe impact in the sense of reducing the EU budget, implicitly the structural funds. Countries that joined the single currency area, for example, witnessed an inflationary pressure in the first two years.

**Table 3**

**Percent difference between import and export values resulted, following different absorption rates of structural funds**

Years	Version 1, pessimistic			Version 2, optimistic		
	Absorption rate (%)	Imports (%)	Exports (%)	Absorption rate (%)	Imports (%)	Exports (%)
2008	30	1.86	0.15	35	2.17	0.18
2009	40	2.47	0.12	48	2.96	0.14
2010	45	2.92	0.07	59	3.83	0.09
2011	60	5.20	0.52	79	6.84	0.69
2012	70	5.55	1.22	89	7.06	1.56
2013	80	4.53	1.87	95	5.38	2.22

Source: Calculations based on Table 2 data.

Another factor of influence which could have an impact on the efficiency of projects implemented by structural funds and on their absorption capacity is the portfolio of foreign direct investments, taking into account the significant decrease in foreign currency receipts from privatization and the increasing importance of "green field" investments, with the participation of foreign capital.

In assessing the structural fund effectiveness during the period 2008-2020, the external debt sustainability over the medium and long terms should be also considered. Their projections by the year 2013 reveal an accumulation of serious lack of sustainability, which was already sanctioned by the international rating agencies (see the country rating of Romania, downgraded by Standard & Poor's in October and by Fitch in November 2008, just as a result of accelerated growth of trade and current account deficits, which will make the access of our country to the international capital markets more difficult and will considerably raise the borrowing costs, affecting the amount and sustainability of external debt).

Last but not least, the macroeconomic impact of structural funds should be correlated with the efficiency of investments and the ICOR (incremental capital output ratio coefficient), whereas the injection of such funds can be considered unqualified as an investment. Until now (but also in the years 2008-2013, according to projections of the National Commission for Prognosis), the ICOR coefficient recorded an upward trend, which means a greater investment effort to obtain an additional unit of production.

The development of the HEROM model regarding the Foreign Trade block should also consider specific variables of different groups of goods imported and exported, the issue of import competition and particularly of immiserating exports, with low value added, which usually means exports of primary (natural) resources, having a disruptive impact on the environment, implying a low eco-efficiency on medium and long term.

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