

Views on the Absorption Rate of the European Social Fund in Romania

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Abstract

Analysis of the absorption rate has a significant importance since it measures the capacity a state or region to make effective and efficient use of the funding available under cohesion policy which is considered the most important EU investment policy. This paper aims to analyze the factors influencing the absorption of EU funds (ESF) in Romania. The analysis will target, in particular the administrative capacity related factors. The methodology developed by the authors to measure absorption capacity was applied to the case of Romania's ESF funded Operational Programs funded during 2007-2013 under Convergence Objective. The results obtained allowed the authors to reveal the main administrative weaknesses explaining why Romania has very low absorption rate; the bottlenecks identified should be lessons learnt and should be properly addressed by Romanian policy makers for 2014-2020 programming period.

Keywords: cohesion policy, absorption capacity, European Social Fund

JEL classification: A10, O20, R58

1. European Social Fund addressing the human capital and good governance challenges under the cohesion policy

The European Union (EU) has been investing in people since it first came into being as the European Economic Community (EEC) in 1957 (Wolff D, 2014). To this end the Member States developed a specific financial tool, respectively the European Social Fund (ESF). Since its creation (the Treaty of Rome in 1957), ESF supported constantly investments in human capital as part of the measures to increase economic and social cohesion and to reduce regional development disparities. ESF is also an important mean for the achievement of the cohesion policy goals. ESF developments followed the developments and transformation of the cohesion policy and developed continuously to better address the human capital goals and priorities under the cohesion policy.

Initially, the cohesion policy was *"primarily concerned with meeting compensatory demands articulated from real or prospective losers of the*

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integration process and the most important integration moves in the history of the EU would not have been possible without side-payments to opponents or adversely affected groups” (Eiselt, 2006). It was also a redistributive policy, designed as “a set of specific funds and Community initiatives redistributing financial resources partly collected from the member states and partly gained from the Union’s so-called traditional own resources through the EU budget” (Eiselt, 2006), of which instruments basically consisted in financial transfers (through EU budget) from more affluent member states to economically weaker member states to foster faster development and to reduce regional disparities across member states. At the time, the European Social Fund (ESF) was aimed at supporting the reduction of regional disparities and it was deployed to help workers in economic sectors that were modernizing their production processes; ESF support addressed, in particular, the short term trainings for workers to improve skills or to acquire new skills to support economic growth. Also ESF provided support for resettlement to help unemployed people relocate for work.

After 1988 -1993 reform, the cohesion policy transformed: from a solidarity policy towards an *investment policy for development objectives supporting balanced economic development, economic gains and competitiveness for regions of the member states*. The allocation mechanisms were no longer exclusively dependent on the level of development of the regions, but rather dependent on the results and impact of the investment activities/projects on economic and social development. Since then, the cohesion policy focused on efficiency indicators as main criteria for allocating funds, and it reoriented on *funding projects generating gains in economic efficiency and competitiveness* for recipient regions; achievement of the policy objective depends more on the capacity of the regions and regional stakeholders to develop efficiency generating projects in support for economic growth and the simple positioning of a region among the less developed ones is no longer the guarantee for being granted more cohesion money. ESF adapted to this new approach under the cohesion policy and it moved from its early relocation and retraining objective towards fighting financial inequalities in the poorest regions of Europe, job creation, funding job-focus programs and employment objectives.

Starting with the programming period 2007-2013, the EU cohesion policy turned into a support and investment policy for regional economic competitiveness: *“cohesion policy should provide opportunities for the future [...] rather than compensation for the problems of the past” (Constantin&all, 2010). The cohesion policy becomes the most important investment policy of the EU to support economic efficiency, employment and competitiveness at regional level. The earmarking of the Lisbon and Europe 2020 priorities into the cohesion policy is considered the key element in reforming of this policy “shifting the focus of cohesion policy from traditional alleviation of regional disparities to enhancing human resources and the knowledge intensive economic activities in prospective competitive parts of the economy” (Kalman, 2014). ESF continues to provide support to the EU member states to effectively address challenges ranging from*

demographic and employment challenges, low success rates in education at the different strands of the education cycle, and inequalities within the labour market and beyond which hinder a number of individuals from leading a dignified life. To support the development and competitiveness goal, ESF enlarged its areas of activities and focused also on good governance and improvement of the quality of the public administrations in the member states, based on the assumption that *“weak administrative structures can seriously hamper a country’s economic development and reduce the efficiency of public spending, be it from local, national or European sources”* (European Commission, 2014). The good governance related priorities of ESF addressed also objectives related to the capacity building for relevant stakeholders for delivering employment, training and social policies and programs, including partners and civil society bodies.

The European Social Fund remains a “soft fund”, used for human resources development, training, educational activities and social inclusion. It may be described as an important tool for policy change and agenda setting, mutual learning and innovation contributing to policy objectives. The European Social Fund (ESF) continues to play a major role in the implementation of economic, social and territorial cohesion policy and is considered one of the European Union’s main financial instrument, aiming at improving human capital through better education and training, better employment, more effective social inclusion measures and better governance.

Allocations under EU Cohesion policy has been constantly growing since the ‘80s and became, at present, the most important item of expenditures; thus, the analysis of the effective and efficient use of these large amounts of financial resources became important for both EU and member states decision makers. After the 2007 enlargement, due to the relative weight of the available funding under cohesion policy heading in the EU budget (347.7 bill EUR for 2007-2013 and 351.8 bill Euro for 2014-2020, representing almost 1/3 of the EU budget resources). The EU ESF allocations in EU-27 for 2007-2013 period had a total value of 76.368 bill. Euro (European Commission, 2015) representing about 22% out of the total EU budget allocations for cohesion policy. For 2014-2020 programming period, the EU ESF allocations maintained close to 22% of the EU allocations for Cohesion policy, with a value of for 80.323 bill Euro (European Commission, 2015). These figures emphasize the importance that the investments in human capital play in European Union for fostering competitiveness and development. Thus, effective use of ESF available resources is a key factor to unlock competitiveness since it significantly contributes to the achievement of targets under the Europe 2020 for smart, sustainable and inclusive growth, particularly in terms of **employment, social inclusion, education and capacity building**.

Access to ESF funding opportunities became available for Romania, after its accession, starting with the 2007-2013 programming period. During 2007-2013, the EU funds for cohesion were distributed, under the Convergence objective, across 7 Operational Programs (OP): Human Resource Development (HRD) OP;

Administrative Capacity Development (ACD) OP; Technical Assistance (TA) OP; Regional OP; Environment SOP; Increase of Economic Competitiveness (IEC) OP; Transport OP. During this period, the European Social Fund represented for Romania an important financial tool to support projects for better education and training, employment opportunities, social inclusion and better governance. During 2007-2013 programming period, in Romania, ESF provided funding for two Operational Programs (OPs) under the Convergence Objective, namely the Human Resources Development OP (HRD OP) and Administrative Capacity (OP). The ESF funded OPs counted for almost 1/5 of the allocations under Convergence objective (see also table 1, below), reflecting the importance given to the human capital and good governance factors to support economic competitiveness and cohesion in Romania. Under HRD OP, ESF was used to support the interventions for increased competitiveness of human capital in Romania. HRD - OP was an important tool supporting investments in human capital as a key resource underpinning the economic development and structural changes. Moreover, investments in human capital will complete and will provide sustainable long term productivity growth. HRD OP general objective targeted the development and increased competitiveness of the human capital, by linking education and lifelong learning with the labor market and ensuring increased opportunities for future participation on a modern, flexible and inclusive labor market for 1,650,000 persons. Specific objectives of the HRD OP consisted of: (a) promotion of quality initial and continuous education and training, including higher education and research; (b) promotion of entrepreneurial culture and improving the quality and productivity at work; (c) facilitation of the integration of young people, and the long-term unemployed into the labor market; (d) development of flexible, inclusive and modern labor market; (e) promotion of (re)insertion on the market work inactive persons, including in rural areas; (f) improvement of public employment services; (g) facilitating access to education and to the labor market of the vulnerable groups. HRD OPs funded both system and individual needs in the field of education, training, employment, social inclusion. the HRD OP Managing Authorities (HRD OP MA) was the Ministry of Labour (until 2013), respectively Ministry of European Funds (since 2013). The Administrative Capacity OP general objective was to contribute to the creation of a more efficient and effective public administration to socio-economic benefit of the Romanian society. The priorities of Administrative capacity OP aimed at addressing the weaknesses identified in policy formulation and management at all levels of the public administration (local and central) by focusing on key elements to strengthen administration accountability and credibility, improve the decision-making process, better regulation, increased responsibility and organizational efficiency for the public administration, and support for effectiveness and improvement of decentralization for improving the quality and efficiency for delivery of public administration services in specific priority sectors (e.g. education, health etc.).

2. The “absorption capacity” and “absorption rate” of EU funds

The new “investment policy” and support for competitiveness approach together with the redistributive function of the cohesion policy intensified the debates over the effective use (“*absorption*”) and impact of the funding under EU cohesion policy, in particular in new member states from Eastern and Central Europe, as main recipients of the funding available. Most of the definitions refer to the absorption EU funds for cohesion as “*the capability of a region or member state to allocate and to fully spend the financial resources under cohesion policy in an efficient and effective way*” (Dragan, 2010; Horvat A, 2005); it measures *the extent to which a state/region is able to fully spend the allocated financial resources from the EU funds in an effective and efficient way* (Kopeva, 2011). Consequently, increased absorption capacity is widely considered a key condition for making a maximum contribution of the EU funding to economic and social cohesion; taken into account also that the EU funding under cohesion policies plays the key role that as main investment instrument, in particular in new member states from Eastern and Central Europe, this could explain the recent interest for understanding and analyzing the absorption capacity and factors of influence with the a view of identifying measures to increase absorption.

Analysis conducted so far about effects of EU funding identified the so-called “absorption problems” (Kalman 2002; Kalman, 2014, Dragan, 2010) which have to be carefully taken into consideration, by policy and decision makers:

- *administrative absorption’ problems* – is resulting in a difference between transfers from EU budget under cohesion policy and the increase in the productive capital in the beneficiary region/member state;
- *rent-seeking problem* – it refers to the people who interfere for the use of EU funds with the view of gaining personal advantages and it becomes manifest through external forms of corruption at various levels (between national governments and EC, between governments and various organizations having interested in accessing EU funding etc.);
- *timing related problems* – EU funding in infrastructure projects consists in long-term focused public investment and may have significant opportunity costs in the short-run, such as delays in private investment decisions or private investment even being crowded out by public sector (Dragan, 2010);
- *prioritization problems* – the inability to the regional/central governments to define a limited number of investment priorities may lead to suboptimal use of EU funding.

Specific factors from both the supply side and the demand side have significant influence on the absorption capacity of EU funds, including the ESF. The absorption capacity on *demand side* means the actual ability of the project applicants to generate acceptable projects (Kopeva&all, 2014) and is largely

dependent on (a) administrative capacity - the ability of applicants and project beneficiaries to prepare and implement good eligible projects and to properly manage the projects so that to reduce the incidence of irregularities and (b) financial capacity - the co-financing capacity of the beneficiaries. The absorption capacity on *supply side* largely depends on the institutional system created in each member state to manage the EU funds (Dragan, 2010) and can be assessed by reference to three distinctive components (Oprescu&all 2005; Kopeva&all 2011; Dragan, 2010; Sumpikova, 2007):

- *macroeconomic capacity* - indicates the rate of the EU funding in terms of the GDP of the recipient member state (limited at 4%);
- *financial capacity* –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 (state, regional and local authorities, private bodies) interested in a programme or project
- *administrative capacity* – the ability and skills of central, regional and local governments to prepare suitable plans, programmes and projects in due time, to decide on programmes and projects, to arrange the co-ordination among principal partners, to cope with the administrative and reporting requirements, and to finance and supervise implementation properly, avoiding irregularities as far as possible (Horvat, 2005; Kopeva&all, 2011). The administrative capacity is dependent by both the design of the implementation system and its functioning (operationalization of rules) and it comprises: (a) structures (clear assignment of responsibilities and task of legal body in the EU funds management for the entire program management cycle: programming, implementation, management, evaluation and monitoring, financial management and control etc.); (b) human resources (adequate supply and availability of qualified personnel, clear job description, personnel performances etc.) and (c) systems and tools (availability and effective use of instruments, methods, guidelines, manuals, systems, procedures, forms) (Kopeva&all, 2011).

The absorption capacity of EU funds is usually measured by “**absorption rate**”, an indicator defined as the level of *verified payments disbursed* as percentage of the *planned allocations* (funding available) for a particular program, region or for a member state. Due of the importance of cohesion funding as investment tool to foster development and competitiveness for many EU member states, the 100% absorption rate becomes a major concern for regional and central governments. Consequently, governments deployed efforts to prevent and manage the *deficiency of absorption capacity* (Horvat&Maier, 2004) and *absorption bottlenecks* (Kalman, 2002).

3. Absorption rate of EU funding: a methodology

Traditionally, when analyzing the absorption rate, it is useful to distinguish between: (a) *contracting ratio* (projects are approved and contracts signed); (b) *absorption ratio* (advance payments plus verified payments disbursed); (c) *certification ratio* (invoices have gone through the national verification and certification process and the certified expenditures sent to Brussels for approval and disbursement of funds); and (d) *final absorption rate*, when projects have been certified by the European Commission (Paliova, 2014).

The authors of this paper combined the methodologies and tools used in specific literature and defined some specific indicators (ratios) **to analyze and explain the influencing factors of the absorption rate of EU funds**, respectively: (a) *internal absorption rate* – verified payments reimbursed (including advance payments) by management authorities (MA) to beneficiaries/total allocations; (b) *final absorption rate* – verified payments disbursed by EC/total allocations. The authors consider the both internal and final absorption rates are dependent on the following variables: (a) *attractiveness rate for potential beneficiaries to access and make use of EU funding* – requested funding (value of projects submitted) against available allocations; (b) the “*success*” *rate of the projects submitted*– value of projects approved and contracted against requested funding (value of projects submitted); (c) *the quality of expenditures incurred in projects contracted* – expenditures reimbursed by national authorities or by EC against value of projects approved and contracted and it measures the capacity of the beneficiaries to effectively spent money for the objectives and activities contracted. The authors assume that *the administrative factors*, from both the supply side and the demand side, have influence over all three variables. Based on these assumptions, the authors of this paper will use the following formulas:

$$\begin{aligned}
 \text{Internal absorption rate} &= \frac{\text{Payments reimbursed by national authorities}}{\text{Planned allocations}} = \frac{\text{requested grants}}{\text{planned allocations}} \times \\
 &\frac{\text{contracted grants}}{\text{requested grants}} \times \frac{\text{payments reimbursed by national authorities}}{\text{contracted grants}} \\
 \text{Final absorption rate} &= \frac{\text{Payments reimbursed by EC}}{\text{Planned allocations}} = \\
 &\frac{\text{requested grants}}{\text{planned allocations}} \times \frac{\text{contracted grants}}{\text{requested grants}} \times \\
 &\frac{\text{payments reimbursed by national authorities}}{\text{contracted grants}}
 \end{aligned}$$

The authors consider that both the internal absorption rate and the final absorption rate are relevant for analysis of the absorption capacity of EU funding. The empirical evidences (statistical data series for 1993-2015, available in various EC reports and national reports) indicates that the final absorption rate is often lower than the internal absorption rate: the difference indicates the performance gap of the payments certification and disbursements (as part of the financial

management and control phases of the EU funded programs cycles) existing between EC services and regional/member states institutions involved in the EU funds management and control. The higher this difference between internal and final absorption rates, the lower the administrative capacity of a member state to effectively perform the financial management of EU funds.

The *attractiveness rate for the potential beneficiaries to access and make use of EU funding* ($\frac{\text{requested grants}}{\text{planned allocations}}$) is determined by:

- (1) *supply side factors* related to:
 - (a) *quality of the programming* of the funds, in particular the capacity to set up the relevant investment priorities for local/regional/sectoral needs; the observance of the *partnership principle* in the programming phase of EU funds becomes an essential prerequisite: the latter motivation to apply for funding is directly dependent on the engagement of relevant stakeholders, potential beneficiaries/ in defining priorities during the programming phase.
 - (b) *quality of the support* provided by the MAs to potential beneficiaries, quality and availability of information about EU funding and funding conditions included.
 - (c) *procedures and conditions for accessing funding* – basically bureaucratic burden, low transparency of evaluation and selection etc. may discourage applicants to apply for funding.
- (2) *demand side factors* related to:
 - (a) *capability of potential beneficiaries* to understand funding priorities and conditions and to prepare eligible projects to be submitted in due time; it is dependent on: access to information about EU funding opportunities; availability of internal capabilities or external resources (e.g. consultants, access to guarantees and credit facilities) to access EU funding.

The *“success” rate* ($\frac{\text{contracted grants}}{\text{requested grants}}$) is influenced by:

- (1) *supply side factors* related to:
 - (a) *quality of the project evaluation and selection processes* - it is dependent of the availability of adequate qualified human resources, tools and procedures for project evaluation and selection: low qualification of evaluators as well as inconsistent evaluation grids/selection procedures will contribute to approval of poor projects..
 - (b) *project pipeline* – activities developed by MAs to assist the beneficiaries in preparing applications
- (2) *demand side factors*, in particular *administrative factors* related to the capacity of beneficiaries to prepare good projects.

The *quality of the expenditures* measured by reimbursement rate $\left(\frac{\text{payments reimbursed by national authorities}}{\text{contracted grants}} \text{ OR } \frac{\text{payments reimbursed by EC}}{\text{contracted grants}} \right)$ is an indicator of the effective project/program budget execution by reference to the compliance with eligibility conditions and it is influenced by:

- (1) *supply side factors* related to:
 - (a) *quality of the implementation, financial management and control*, in particular the capacity of the institutions to define and apply adequate procedures for the performing expenditure verification and project monitoring, irregularities detection and management;
 - (b) *quality of the support* (through help desk activities) provided to the beneficiaries to prevent occurrence of ineligible expenditures and irregularities.
- (2) *demand side factors* related to:
 - (a) *quality of the project management* – the capacity of the beneficiaries to comply with specific expenditures eligibility rules and procedures, depending on access to information, availability of personnel or to consulting services for the project implementing/management/financial management etc.
 - (b) *operational capacity of beneficiaries to implement the project* – availability of resources to develop project activities, capacity to achieve project objectives and targets;
 - (c) *financial capacity of the beneficiaries to implement the project* - it includes both availability of internal financial resources as well as access to other sources of external funding (e.g. access to credit facilities) to implement projects and manage cash-flow difficulties.

To increase the quality of the analysis of the absorption rate, the methodology presented above should be complemented by: surveys and in-depth of the activities of MA, analysis the typologies and capabilities of the beneficiaries under each Operational Program.

There are some limitations of this methodology that should be taken into account. The methodology explains which are the variable influencing the absorption rate of EU funds. Calculations may be influenced by exchange rate variations. The ratios uses (attractiveness rate, success rate, quality of expenditures) are explaining variables of the absorption rate and absorption capacity, but they give limited indications about the effectiveness and impact of the EU interventions. It means that analysis does not provide any information about the quality of the results of the actions funded by EU funds. The absorption rate remains an indicator providing information about the capacity of a region/member state to spend the EU funds allocated, *but it gives no indication or limited indication about the costs incurred to spend the EU money (mostly “hidden costs”) and about the impact of resources spent on target groups/sectors/regions*, in

particular about the effectiveness of available funding for the development and competitiveness goals. Any analysis of the absorption rate and absorption capacity should be complemented by analysis related to the result and impact evaluations.

4. Explaining the ESF absorption rate: main findings for Romania for the 2007-2013 programming period

The focus of this section is to analyze the variables and factors influencing absorption rate of the European Social Fund in Romania, in particular to identify administrative bottlenecks contributing to the lowest absorption rate in EU-27 (measured at end July 2015). Based on the most recent official data (Ministry of European Funds, July 2015), the authors calculated the indicators described in the methodology section; the calculations are presented in table 1 below.

Table 1. Absorption figures in Romania for ESF and average values for the Convergence OPs during 2007 – 2013 (1)

	HRD OP	Administrative Capacity OP	TOTAL Convergence Objective
EU planned allocations (bill. Euro)	3.476	0.208	19.058
Applications submitted (no.)	17,216	1,372	46,904
Main categories of applicants	Public administration, large companies and SMEs, NGOS, trade unions, public institutions, education and research institutions etc.	Local and central administration, universities (relevant NGO participation as partner)	
Applications submitted (bill Euro)	17.238	0.732	53.682
Contracts signed (no.)	4,092	455	15,633
Contracts signed (bill Euro)	4.491	0.252	20.909
Average value of an application (mill Euro)	1.001	0.533	1.145
Average value of a contract (mill Euro)	1.097	0.554	1.337
Internal payments (2) made by MAs (bill Euro)	2.594	0.173	13.190
Payments made by MAs included in Declarations of Expenditures submitted to EC (bill Euro)	1.64	0.171	10.620
EC reimbursements (bill Euro)	1.158	0.17	9.914

	HRD OP	Administrative Capacity OP	TOTAL Convergence Objective
<i>Average value of an application (mill. Euro)</i>	1.001	0.533	1.145
<i>Average value of contract (mill. Euro)</i>	1.097	0.554	1.337
<i>Applications not contracted (no)</i>	13,124	917	31,271
<i>Applications submitted not contracted (bill. Euro)</i>	12.748	0.479	32.774
<i>Internal payments made by MA not included in Declarations of Expenditures submitted to EC (bill. Euro)</i>	0.954	0.002	2.571
<i>Payments in Declarations of Expenditures not reimbursed by EC (bill Euro)</i>	0.482	0.001	0.706
<i>Share of no. of projects contracted in total number of applications submitted (%)</i>	23.77%	33.16%	33.33%
Attractiveness rate (%) (3)	495.92%	351.72%	281.68%
Success rate (%) (4)	26.05%	34.48%	38.95%
Quality of expenditures: Internal reimbursement rate (%) (5)	57.76%	68.53%	63.08%
Quality of expenditures: EC reimbursement rate (%) (6)	25.79%	67.39%	47.42%
Infernal absorption rate (%) (7)	74.62%	83.10%	69.21%
Final Absorption rate (8)	33.31%	81.73%	52.02%
<i>Difference between Internal absorption rate and final absorption rate (percentage points)</i>	41.30%	1.37%	17.19%

Notes:

- (1) All values presented in the table reflects exclusively the EU non-reimbursable assistance (not including Romania public or private co-financing of the projects or OPs) and are expressed in Euro; the exchange rate used is the Inforeuro Exchange rate of 1 EUR = 4.4083 ROL
- (2) Internal payments includes payments made by MAa (it included both advance payments and expenditures made by project beneficiaries and reimbursed by Managing Authorities);
- (3) Attractiveness rate = value of the submitted applications/EU value of planned allocations
- (4) Success rate = value of the contracted grants/value of the submitted applications
- (5) Internal reimbursement rate = Internal payments made by Managing Authorities/Value of contracts signed
- (6) EC reimbursement rate = EC payments /Value of contracts signed

(7) *Internal absorption rate = Payments made by Managing Authorities/Planned allocations*

(8) *Final absorption rate = EC payments/planned allocations*

Source: Romanian Ministry of European Funds, <http://www.fonduri-ue.ro/files/implementare-absorbtiie>

The figures in table 1 provide overall information about the ESF funded OPs: (a) ESF represented over 19% of the EU allocations; (b) SOP HRD had a broad range of beneficiaries (education and research institutions, civil society stakeholders, SMEs, central and public administration, trade unions etc.), while the Administrative Capacity OP had public administration as main beneficiaries; (c) Administrative Capacity OP had funded small project (low value of budget), while the HRD OP had large number of projects of an average value closed to the average value for Convergence Objective; (d) both OPs had attractiveness rate higher (almost twice) as compared the average attractiveness rate of the funding opportunities available under Convergence Objective.

As shown in table 1, at end July 2015, the final absorption rate was at 52.02%, the lowest rate in EU-27. The final absorption rate is 17.19 pp lower than internal absorption rate, due to: (a) incidence of the advance payments from EC; (b) low performance of MAs to certify and reimburse expenditures to the beneficiaries and to prepare and submit Declarations of expenditures to EC; (c) incidence of irregularities observed by EC for the expenditures declared by MA, leading to corrections and payment suspension (several suspension in case of HRD OP). Because of the non-reimbursed expenditures by EC (together with corrections and payments suspension), Romania redirected, at least temporarily, national funds from other investment priorities to continue funding projects contracted under the 7 OPs. The main adverse effects consisted of: (a) sub-optimal allocations of national funding; (b) low availability of EC reimbursements to be reintroduced in payments disbursement flows with adverse effects of beneficiaries cash-flow and project budget execution which could lead to temporary fiscal burden on national budget.

From the perspective of the *attractiveness rate*, The ESF funded OPs were very attractive for potential beneficiaries. The ESF funded OPs had very high rates of attractiveness as compared to the attractiveness rates of other OPs funded under Convergence objective. The attractiveness of the ESF OPs may be associated also to the relatively "softer" content of the operations funded, respectively the "infrastructure" component, in particular the European Regional Development Fund type expenditures, was limited to 10% of the eligible expenditures and mostly consisted in equipment procurement. From this perspective, the ESF funded projects seemed easier to be implemented for most potential beneficiaries. With a view to the absorption capacity, the information presented in table 1, allows the authors to conclude for these OPs:

- there is an acceptable of the quality of the programming, respectively the OPs priorities addressed relevant needs of the regions, sectors and applicants; this is associated to good administrative capacity to set up

investment priorities to address specific the needs and challenges related to human capital and good governance;

- there is good capability of the applicants to prepare applications; this also reflects good administrative capacity of applicants to prepare applications and to submit them in due time.

Looking together to both attractiveness rate and the typology of the beneficiaries, the authors concluded that the attractiveness of the OPs depends on the typology of the eligible beneficiaries: the more diversified the typology, the more attractive the OP from the point of view of applications submitted. Under ESF funded OPs, there were submitted 18,588 applications, representing over almost 40% of the total applications submitted for all OPs under Convergence Objective. Apart of the positive implications of this situation, the increased attractiveness for ESF OPs, there are also negative effects, such as administrative burden for evaluation and selection activities of the MAs leading to longer period of evaluation and adverse impact on the quality of the evaluation.

The *success rate* for Convergence Objective, had an average value of 38.95% reflecting that the capability of applicants to prepare **good** applications to be selected and contracted remains very low (only 1/3 of the applications submitted were approved and contracted). This low capability seems to be specific to local public administrations (very much dependent on internal capabilities), to SMEs and NGOs (limited financial capability to use consultancy services); this conclusion is supported by empirical evidences: *low success rate* is specific to the HRD OP, ACD OP which have as main beneficiaries SMEs, NGOs, local public administrations, research organization, trade unions. There is no information available about the quality of the evaluators and the quality of the evaluations performed, so the authors cannot analyze how and at which extent, administrative capacity of the Managing Authorities (e.g. the evaluators' performances and evaluation procedures) influenced the contracting rate across various OPs. To increase the success rate, the MAs should pay a particular attention to the project pipeline preparation activities and support provided to applicants, in particular for major projects.

According to the data presented in the table 1 above, during 2007 – 2013, in case of the *quality of payments*, the following conclusions could be drawn:

- *internal rate of reimbursement* of 63.08% (for all OPs under Convergence objective) is very low taking into account the time of the analysis and the need for compliance with N+2 rule (4 months before expiration of N+2 rule which allows beneficiaries to make payments only until 31.12.2015 and to reimbursed by mid-2016) which makes the 100% absorption target impossible to be reached. This low rate is the result of: (a) poor performance of the MAs to reimburse payments to the beneficiaries in due time; main causes reside in: insufficient qualified personnel, bureaucratic and ineffective procedures of expenditures checks and controls; (b) low execution of budgets at project level, significantly dependent on the: (i) financial and

operational capacity of beneficiaries (ii) cash flows difficulties induced by poor performance of MAs to reimburse beneficiaries in due time; (c) incidence of irregularities reflecting low financial management capability of the beneficiaries .

In this respect, the HRD OP is the worst performing (57.76%) because, in particular of: (a) excessive bureaucracy and administrative burden for expenditures checks; (b) insufficient qualified personnel; (c) incidence of irregularities. Another main reason for this OP poor performance resides in its complexity and diversity (the most diverse typology of beneficiaries, with diverse financial regime and constraints) which made also the verifications very diverse and heterogeneous, if specific particularities of each category of beneficiary legislation are taken into account. The administrative burden was specific to HRD OP MA's financial management and control tasks (highest number of projects with hundreds of expenditure items of low value, together with high number of supporting documents for each item of expenditure) and made verification more difficult, time consuming and less effective.

- *EC rate of reimbursement*: of 47.42% for the OPS under Convergence is very low indicating low administrative capacity, in particular from the supply side factors, respectively: (a) low capacity of MAs to prepare Declarations of expenditures and to claim the reimbursements to EC (19.94% of the internal payments disbursed by MAs were not declared yet to EC); (b) low certification capability at national level; (c) incidence of irregularities observed by the EC by reference to the nationally certified expenditures. The worst performing OP is still HRD OP for the same reasons presented above.

The time delay between EC disbursements and MA internal payments to beneficiaries is very little explaining the large difference (15,67 pp) between internal and EC reimbursement rates. The HRD OPs is the worst performing from this perspective, respectively with a "reimbursement gap" (difference between EC reimbursement rate and Internal reimbursement rate) of 31.97pp, almost twice higher as compared to a gap of 16.67pp for the Convergence objective. This significant gap contributes to temporary fiscal burdens for the government, have adverse effects under the form of diversion of the national funds for other investment priorities and raises doubts about the optimal allocation of national funds.

The incidence of irregularities may explain, at some extent, this gap. According to the official reports (EC, *Fight against fraud 2013*, Annual Report, SWD 2014), in 2014, Romania ranks among the first six champions of the irregularities, "together accounting for 2/3 of the total alleged EU frauds"; the *poor administrative capacity* remains the main factors explaining the high incidence of irregularities, frauds included: "Romania has difficulties in identifying and preventing fraud in the European funds absorption process" (Buggenoms S, head of EC Audit Unit, quoted in Campeanu V, 2014). The high irregularities incidence is also influenced by poor management capabilities of the *beneficiaries*,

which implies insufficient administrative capacity of the beneficiaries for the project implementation.

This significant gap also reflects the existing performance between EC services and Managing Authority in performing effective verifications. Most of the verifications performed by HRD OP MA consisted in administrative checks which were not complemented by effective on the spot checks and on the spot monitoring activities; the limited availability of the physical progress of the project (based on the information collected through on the spot monitoring) made the verifications even more bureaucratic with negative effects on the effectiveness of the checks and very long delay for the payments disbursed by the Managing Authority.

From the demand side perspective, both internal and EC reimbursement rates are also dependent on the execution of the budgets for contracted projects. The poor capacity of HRD OP MA to perform expenditures verification and financial management in due time (according to contractual terms) altered the capacity of the beneficiaries to implement and spend the contracted budget. Due to administrative burden and poor administrative efficiency, the HRD OP MA experienced the longest delay for expenditures verification and payments reimbursed to beneficiaries: in 2013, the average duration for reimbursing beneficiaries was of 120 days, almost 3 times longer as compared to the contractual duration of 45 days (Jaliu D, 2013) The infringement of contractual delays for payment reimbursement created cash flow difficulties to beneficiaries, with negative effects on the capacity of the project beneficiaries to implement, to perform effective financial management and to co-finance their projects. Thus, the authors consider that poor administrative performance of HRD OP MA to perform financial management and control tasks produced a "vicious circle": large delays for payments reimbursement generated cash difficulties for beneficiaries which negatively affected the implementation speed of activities and the rate of project budget executions (payments made against contracted budgets); thus, the financial difficulties produced by poor HRD OP MA capacity to the beneficiaries reduced the possibilities to use the reimbursements as financial resources to be reintroduced on the project and program cycle for funding project activities. Consequently, depending on the financial capacity of beneficiaries, the value of the reimbursement claims slowly decreased in absolute values: the lower the amounts claimed by beneficiaries, the lower the value of payments reimbursements by HRD OP MA generating lower disbursements made by EC and consequently lower absorption rates. At present, there is no evidence available about the actual payments made by the beneficiaries and not included in the reimbursement claims presented to MAs; thus, any further analysis of the beneficiaries budget execution influence over reimbursement rate cannot be conducted.

Conclusions

The exclusive focus of public policy and actions undertaken by a member state on increased absorption rate of governments could generate negative adverse effects and hidden costs which may consist of (Herve & Holman, 1998 quoted in Paliova, 2014): (a) direct adverse impact due to suboptimal management of the funds, for instance because of undue political interference, mismanagement, or even corruption; and (b) indirect adverse effect due to distortion of relative prices in case of economies with supply constraints, for instance, if there is structural unemployment due to rigid labor markets and/or by affecting private investments or creating temporary but unsustainable growth that blurs and delays overdue structural reforms. If the obligation to co-finance EU programs/projects under cohesion policy is also taken into account, it seems that the EU funding may cause an additional fiscal burden (Paliova, 2014) to member states, in particular the less developed ones. During 2007-2013, some member states faced short term fiscal burden and liquidity problems in implementing projects and reimbursing project beneficiaries due to the EC decision to temporarily suspend payments for some specific programs. Thus, when analyzing absorption, it is important to pay attention to the process of prioritizing investments (programming phase of EU funds) and to the quality of spending for the contracted projects (implementing, financial management and control phases).

Based on 2007-2013 experience, for Romania, the supply side factors, in particular related to administrative capacity, seem to have the largest influence over the absorption rate. The low absorption rate was the outcome of poor efficiency and effectiveness of public administration – Managing Authorities –, on the one hand and of high structural deficits (European Parliament, 2013), on the other hand. The main identified weaknesses for the Managing Authorities refer to poor performance due to lack of skills, poor transparency in staff recruitment and management, ineffective procedures for verifications, in particular related to financial management and public procurement.

Based on 2007-2013 experience, for Romania, the supply side factors, in particular related to administrative capacity, seem to have the largest influence over the absorption rate. For increased and effective absorption during 2014-2020 period, Romania should focus on measures addressing the administrative weaknesses identified, in particular: (a) development of effective actions for project pipeline preparation and support for beneficiaries to increase the success rate of the projects; (b) increased performance for financial management and control (e.g. simplification and increased effectiveness of procedures for expenditures checks and certification to reduce ineffective administrative burden and incidence of irregularities; more frequent monitoring activities to provide real time information about project field progress accompanying procedures for expenditures checks and controls, increased focus of controls on results and not on formal and administrative issues); (c) reduction of the administrative burden (in particular referring to reporting and documents to be presented for reimbursement

claims etc.); (d) provision of a better and more effective support for beneficiaries, by improved and efficient help desk activities, to prepare good projects and to reduce incidence of irregularities and e ineligibility of expenditures during project implementation phases.

Increasing the administrative capacity is important determinant for the effective use of European Social Fund and other EU funds under cohesion policy. *Ultimately, the poor administrative capacity related to ESF funded projects in Romania is reflected in the low absorption rate; the ultimate costs of low absorption rate are reflected by reduction of funding available to support investments in human capital and for improving governance with severe negative effects leading to increasing development and competitiveness gap.*

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