



The (low) absorption of EU Structural Funds

SUMMARY At present, the European Union (EU) faces the difficult task of exiting the economic crisis while achieving the transition to a more dynamic and competitive economy. Cohesion policy and its Structural Funds are one of the main EU instruments to sustain economic growth, while reducing disparities between regions. These funds are allocated to Member States (MS) under a complex legal framework, according to the level of development of their regions.

Paradoxically, according to researchers, the most economically disadvantaged regions are also experiencing the greatest difficulties in spending (absorbing) these funds.

Among the reasons accounting for low absorption in the 2007-13 period are: the economic crisis, insufficient administrative capacity, changes in national/regional governments, and the effects of national sectoral reforms.

To increase absorption, in 2011 the Council and Parliament (EP) adopted a Regulation allowing a temporary increase of EU co-financing rates by 10% for MS experiencing financial difficulties. In 2013, the European Commission proposed additional measures to reduce the risk for some MS of losing unspent funds.

Financial experts assert that the involvement of banks and private companies in Structural Funds implementation can increase absorption. The EP highlights the need for simplification and flexibility of rules at both EU and national level to improve absorption.

In this briefing:

- Background
- What is absorption and why it matters
- The complexity of EU Cohesion policy
- Absorption: features and issues
- Private sector involvement

Background

Cohesion policy aims to reduce the economic, social and territorial disparities between EU regions. Its implementation through the Structural Funds is one of the main axes of EU action in delivering the [Europe 2020 Strategy](#) for growth and jobs. With over €348 billion under the [2007-13 Multiannual Financial Framework \(MFF](#) – which establishes the global EU budget for the period), it represents the second largest item in the EU budget, after agriculture.

The policy has been the subject of great interest due to the potentially high opportunities it may offer to leverage funds, in particular, against the background of the current [economic and financial crisis](#). In April 2013, the Commission [reported](#) that, since 2007, nearly 400 000 jobs have been created, over 53 000 start-ups received support, 2.6 million people were served by water-supply projects and 5.7 million people by waste-water projects. However, the contribution of Cohesion policy to convergence, higher growth, and job creation remains an open question, with scientific [views varying substantially](#).

Since the inception of Cohesion policy, considerable attention has been devoted to analysing and improving the performance of the Structural Funds. Yet, recent Commission [analysis](#) (2013) reveals that MS still experience difficulties in spending the financial resources from these Funds, particularly in the current (2007-13)



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programming period.

Tackling low absorption (spending capacity) is one of the aims of the ongoing reform of Cohesion policy for 2014-20, which the EP and Council are currently discussing.

What is absorption and why it matters

A possible definition

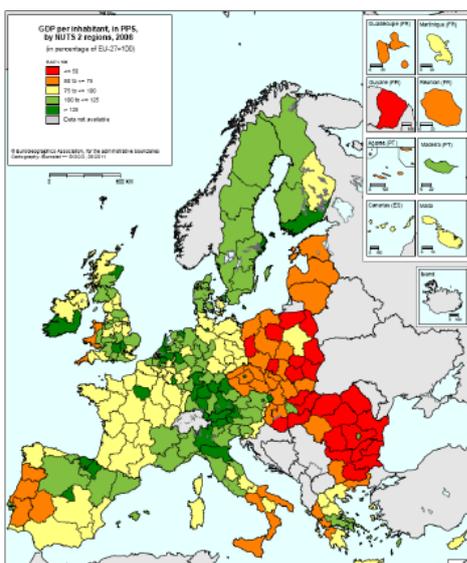
Absorption capacity represents the extent to which a country is capable of effectively and efficiently spending its Structural Funds allocation, and is expressed in percentage of the total allocation. [Experts](#) relate absorption to three main features:

- **macroeconomic capacity**, current Cohesion policy rules limit¹ the transfer of EU funds to a maximum of 3.8% of the respective country's gross domestic product (GDP);
- **financial capacity**, i.e. the ability to co-finance the programmes and projects supported by the EU;
- **administrative capacity**, i.e. the ability of central and local authorities to manage the EU programmes and projects.

The importance of absorption

[Research papers](#) underline the existence of a direct link between low absorption and the uneven development of EU regions.

Figure 1: GDP per capita in PPS, by NUTS 2 regions, 2008



Source: Eurostat, [Statistics in focus](#), 46/2011.

The latest [Eurostat report](#) (2011) on regions' evolution reveals that regional disparities are still very strong (see Figure 1). The regions with the highest per capita GDP are in southern Germany, south-eastern UK, northern Italy, Belgium, Luxembourg, the Netherlands, Austria, Ireland and the Nordic countries. The weaker regions are concentrated in the southern, south-western and south-eastern parts of the Union, mainly in the 12 MS that joined the EU in 2004 and 2007 (EU-12). More than three-quarters of the regions with GDP of less than 75% of the EU average are situated in the EU-12. The eight poorest regions in the EU are all in Bulgaria and Romania.

However, [experts](#) warn that high absorption *per se* is not sufficient to deliver economic growth.

The complexity of EU Cohesion policy

[Practitioners](#) argue that various challenges associated with the absorption of EU Structural Funds are related to the complex system of implementation, management and control at EU, national and sub-national levels.

Policy rationale

Structural Funds programmes are designed and implemented in a 'shared management' system between the Commission and the MS. The Cohesion policy framework is currently set for seven-year periods.

Since the reform of 1988², four key principles guide EU Cohesion policy: **concentration** (funds are focused on the least developed regions), **partnership** (involvement of regional and local authorities in the planning, implementation and monitoring phases), **programming** (priorities are fixed for multi-year periods), and **additionality** (financing through the Structural Funds is not intended to replace, but to complement national investments in the same fields). The policy takes shape in various stages from conception through implementation, management, and control.

Operational management

The Structural Funds' budget and rules for its use are decided jointly by the Council and EP based on a proposal from the Commission. The priorities of Cohesion policy are selected and agreed upon in a process of consultation between the Commission and MS.

Cohesion policy does not fund stand-alone projects. Instead, each MS produces a [national strategic reference framework](#) (NSRF), which outlines the country's strategy and proposes a list of [operational programmes](#) (OP). The Commission validates the NSRF, as well as each OP. The OPs present the priorities of the MS and/or regions and are managed and implemented by the national authorities.

At the beginning of each programming period, funding for each year is allocated to the programmes. These funds must be spent by the end of the second year after their allocation (known as the N+2 rule). The Commission monitors each OP, alongside MS, and prepares [strategic reports](#) on the implementation of the programmes.

Funds and objectives

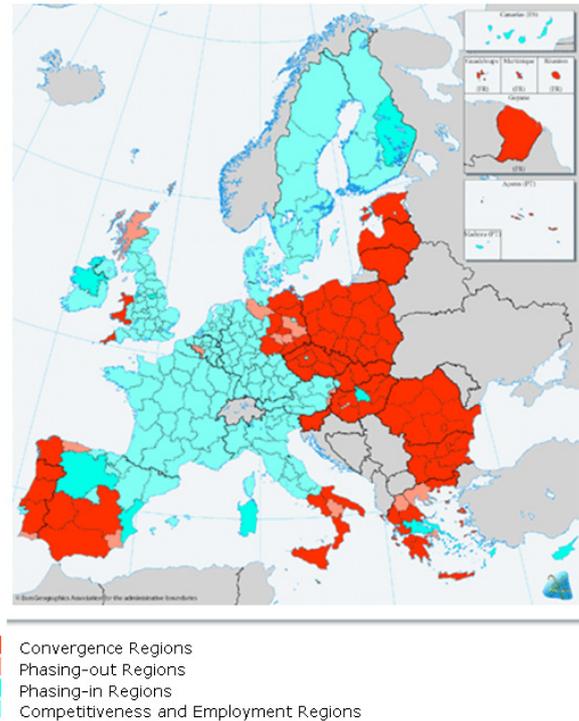
There are two Structural Funds - the **European Regional Development Fund** (ERDF) and the **European Social Fund** (ESF) for regions whose per capita GDP is below 75% of the EU average - and a **Cohesion Fund**³ (CF) intended for countries whose per capita GDP is below 90% of the EU average.

Projects funded through the Structural Funds are based on co-financing between the EU and MS. National co-financing is required to strengthen project ownership and sound management.

The largest part of Structural Fund resources ([82% for 2007-13](#)) are concentrated on the poorest regions and countries (see Figure 2).

MS' allocations⁴ are calculated on the basis of relative regional and national prosperity and the unemployment rate, using the method set out in Annex II of [Regulation 1080/2006](#).

Figure 2: EU regions and corresponding Cohesion policy objectives, 2007-13 (at NUTS 2 level)



Source: [European Commission](#), 2013.

EU co-financing rates are allocated on the basis of the relative level of development of the MS supported, the Cohesion policy objective under which the project is financed, and the fund under which the support is provided:

- the **'Convergence objective'** aims to accelerate the convergence of the least developed MS by improving growth and employment conditions. The EU co-financing for this objective amounts to between 75% to 85% of the eligible costs of projects for the ERDF and the ESF, and to 85% for the Cohesion Fund;
- the **'Regional competitiveness and employment objective'** intends to prepare for economic and social change, promote innovation, entrepreneurship, and environmental protection. Measures under this objective can receive ERDF or ESF co-financing of 50% to 85%;
- the **'European territorial cooperation objective'** aims to strengthen cooperation at cross-border, trans-national and inter-regional levels in the fields of urban, rural

and coastal development. The EU co-financing rate for this objective under the ERDF amounts to 75%.

Cohesion policy 2014-20

To increase the impact of Cohesion policy in the period 2014-20, the Commission [proposed](#) a number of important [changes](#) in the way the policy is designed and implemented. These are currently being [discussed](#) by the Parliament and Council. The focus on fewer investment priorities would be at the heart of new Partnership Contracts, which MS would agree with the Commission. A financial performance reserve, to reward regions who do best in reaching their goals, would be put in place. To ensure that the impact on growth and jobs of EU investments is not undermined by unsound macro-economic policies or by weak administrative capacity, the Commission would be able to review programmes or suspend funding if remedial action is not taken. The rules governing the Funds would also be simplified and harmonised.

Absorption: features and issues

Determinants of absorption

[Experts](#) argue that high absorption depends mostly on ***institutional factors***, both at EU level (e.g. consistency and increased co-ordination in the fund allocation process) and at national level (e.g. political system: federal vs. central). Absorption capacity is usually positively correlated to the ability of central and regional authorities to prepare consistent multi-annual plans, to cope with the substantial amount of administrative work, and, finally, to finance and supervise implementation, avoiding fraud, clientelism and corruption.

[Researchers](#) assert that ***political stability*** is also relevant in determining positive administrative performances. Lack of such stability could undermine the continuity, consistency and coherence required for the successful implementation of a long-term programme.

The [Commission](#) has identified some additional factors which delayed the absorption of funds in the 2007-13 period.

Those include the late start of programmes due to the extension of the previous period, an underlying lack (or even decline) in administrative capacity, the challenges in preparing major infrastructure projects and obtaining Commission approval, changes in EU legislation, inconsistent political ownership (changes in national and regional governments, changes to institutions) and the effects of national sectoral reforms.

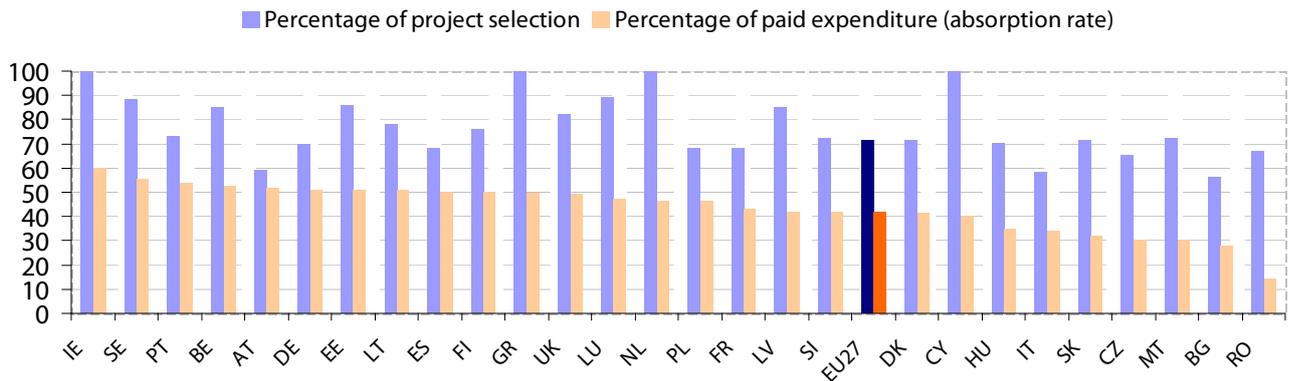
The low absorption paradox

Bearing in mind that the absorption capacity is believed to be influenced mainly by the administrative-managerial and co-financing capabilities, [practitioners](#) claim that the relationship between the absorption capacity and the economic situation of a given region is a paradoxical one. According to them, the most disadvantaged regions also experience greatest difficulties in the absorption of funds. At the same time, they are the regions which need the greatest financial support for the restructuring of their economies.

Tackling low absorption

In 2011, the EP and Council adopted a [regulation](#) providing for a temporary increase in EU co-financing rates by ten percentage points for MS experiencing financial difficulties. At the time, those included Greece, Ireland, Portugal, Hungary, Latvia and Romania (Spain and Cyprus joined the mechanism in 2012).

In 2013, the Commission [proposed](#) additional measures allowing for increased payments to these countries (and any other MS which comes under financial strain in the future) to be made without modifying their overall allocation. Specific provisions for Romania and Slovakia would allow the risk of losing funds from their financial envelopes for 2011 and 2012 to be reduced. According to the N+2 rule these allocations should be spent by the end of 2013 and 2014 respectively, but the two countries would be allowed one more year (until 2014 and 2015 respectively). The regulation is currently [awaiting](#) decision by the EP and the Council.

Figure 3: Percentage of project selection (2007-11) and paid expenditure (2007-January 2013)

Source: European Commission, [Strategic report on implementation 2007-13](#), 2013.

MS progress towards [absorption](#)

According to the latest [Commission report](#) on the implementation of Cohesion policy (2013), the picture across MS is diverse (see Figure 3). Absorption is higher in Austria, Belgium, Portugal, Sweden, and Ireland. Lower absorption rates have been recorded in Italy, Slovakia, Czech Republic, Malta, Bulgaria, and Romania. There is a growing risk in these countries that a significant volume of the EU funds available is lost and the intended objectives are not achieved.

[Experts](#) assert that the main reason for the low absorption in the 2007-13 period is the late agreement on the EU's MFF for the same period, and consequent delays in the negotiations of the NSRFs and the OPs. Moreover, the late start of the programmes then coincided with the economic and financial crisis.

The same experts argue that the EU-12 as a whole perform only marginally worse than the EU-15. However, the EU-12 have a lower commitment ratio, suggesting less efficiency in the evaluation and selection of projects.

Higher absorption vs. efficient absorption

[Experts](#) agree that raising absorption is a valuable policy objective. However, they say the key question remains whether EU funds are used for the right projects and whether they are successful in meeting the objectives for which they have been designed.

European Parliament views

In its [resolution](#) on absorption (2011), the EP identified the most frequent problems (e.g. insufficient national financial resources, inadequately trained staff, disproportion between the degree of control and the scale of the project, etc.) and highlighted the need for simplification and flexibility of rules and procedures at both EU and national level.

Absorption as a condition for assistance

Higher absorption of EU funds has been included as a condition for disbursement of EU loans to three countries receiving EU [financial assistance](#): Greece, Latvia and Romania.

The financial assistance programme for [Greece](#) contains a list of actions that the Greek government needs to undertake in order to raise the absorption rates of the Structural Funds. These include: accelerating the process of preparation and selection of project proposals; establishment of a central account to collect budgetary appropriations intended to co-finance Structural Funds' projects, and the creation of a government task force in direct contact with Commission staff. These measures address the most typical absorption problems: lack of proposals, weak budgetary planning and poor administrative capacity.

The adjustment programmes for [Latvia](#) and [Romania](#) also require, as a condition for the disbursements, that their governments put

aside resources for the co-financing of EU projects, and demonstrate efficient spending of EU funds by meeting specific expenditure targets laid down in the adjustment programmes themselves.

Reasons for low absorption in Romania

The Romanian [National Reform Programme 2011-13](#) identifies the main reasons limiting growth. Two of them – low efficiency, effectiveness and independence of public administration and high structural deficit of the consolidated budget – are directly linked to low absorption.

The [Commission assessment](#) of the Programme also confirmed that poor administrative capacity is a core concern for Romania. It pointed out that public administration is characterised by a "*lack of skills, poor transparency in staff recruitment and management, and high turnover rates*", all of which contributed to a low rate of absorption of EU funds in the current programming period, with Romania ranking last. Common weaknesses singled out by [researchers](#) include the legal framework for financial management, public procurement procedures, and the availability of appropriate funding lines in the national budget.

Private sector involvement

To enhance public investment, the Commission has developed [financial engineering instruments](#) (FEIs) such as [JEREMIE](#), and [JESSICA](#) with the European Investment Bank, the European Bank for Reconstruction and Development, and the Council of Europe Development Bank. Their purpose is to enable public sector capital to be used on a commercial basis (e.g. through holding funds, venture capital funds, loan funds and

guarantee fund mechanisms) and to stimulate the involvement of private-sector capital. [Researchers](#) assert that FEIs can accelerate absorption mainly through unlocking new sources of finance, even though they note a divergence between the objectives of the Structural Funds and the FEIs (e.g. solidarity vs. efficiency).

[Financial experts](#) claim that the involvement⁵ of the banking sector and of profit-oriented companies in various phases of the selection and implementation of EU co-financed projects, can also contribute to improving absorption. Several MS have experimented with using banks as intermediary bodies to accelerate absorption, in particular in channelling funds to SMEs. Banks may perform *inter alia* the functions of project assessment, fund disbursements, monitoring and reporting to public administrations and on-site inspections. This may entail several advantages for public administrations, as banks would select eligible projects which they are prepared to support through pre-financing and co-financing, thereby leveraging grants available.

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Endnotes

¹ [Experts](#) argue this arrangement had a mainly political background to avoid an excessive burden for the EU-15 after enlargement.

² In line with [Regulation](#) 2052/88 and [Regulation](#) 4253/88.

³ In this briefing, the expression 'Structural Funds' refers to all three funds.

⁴ It should be [noted](#) that for the period 2007-13, the unconstrained amounts based on the allocation method described in [Regulation](#) 1058/2006, exceeded the 3.8% capping for nine out of ten 'new' MS, especially for Romania (17.8%), Bulgaria (13.1%), Latvia (9.8%), Lithuania (8.4%) and Poland (7.9%). In the absence of capping, the total amount of Structural Funds payments would have amounted to more than €500 billion instead of the current €347 billion.

⁵ For instance, in Italy commercial banks perform functions of intermediary bodies. In Hungary these functions are performed by profit oriented companies. Greek commercial banks have been closely involved in the process of EU funds absorption since 2001.