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Financial Absorption Rates in EU Objective 1 1994-99 and Some Lessons for the New Member States in 2004-2006

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 **WORKING PAPERS**

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in EU Objective 1 1994-99
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Andrej Horvat

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Financial Absorption Rates in EU Objective 1 1994-99

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Andrej Horvat*

Abstract

In this paper we would like to draw attention on the fact how important for the absorption of the EU funds might be each country's or region's split of its financial portfolio between EU, national and private sources of co-financing. Based on data from the *Ex-Post Evaluation 1994-99*, this paper provides information on financial absorption in the Objective 1 areas of Member States in the 1994-1999 period. We were interested in which financial components are 'more easily' absorbed and, consequently, what lessons regarding the potential "allocation trap" for the New Member States could be drawn here? We also compared our results with the situation in the programming documents of Hungary, the Czech Republic, Slovakia, Estonia and Slovenia made respective conclusions.

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Introduction

A review of academic and EU-internal literature indicates the absence of a conceptual framework to comprehensively assess the issue of absorption problems relating to Structural Funds². Therefore, we must look at literature on absorption problems also in fields such as development economics and public choice. Further, the topic of how to manage Structural Funds is quite rarely described in academic literature³.

Reports formally required by the EU's Structural Funds General Regulations⁴ with the purpose to monitor and evaluate execution of programmes are Ex-Ante Evaluation, Mid-Term Evaluation and Ex-Post Evaluation. Each of these evaluations has the aim of accompanying the Structural Funds through the whole programme cycle, namely, programming (Ex-Ante Evaluation), implementation (Mid-Term Evaluation), and evaluation (Ex-Post Evaluation). However, neither evaluations nor the annual reports on Structural Funds provide a comprehensive presentation of the absorption of Structural Funds by countries through the whole programme period.

The structure of the paper is the following:

First, we carry out simple calculations of *financial absorption* in Objective 1 countries and regions, namely, the ratio between *planned* and *actual expenditure* in the period 1994-99 (see **Ex-Post Evaluation 1994-99 (2003, Annexes)**). The information expected here is the relative success or failure of one or another country/region, group of countries, and in particular of financial components with regard to the Structural Funds spent.

Second, Objective 1 countries/regions will be split into *two groups of countries*: Cohesion Countries (hereinafter: CCs) and Non-cohesion Countries (hereinafter: Non-CCs). The question here is whether CCs are better in absorbing the Structural Funds or does in fact the opposite apply, namely, Non-CCs' financial absorption rates are higher. Since in that period Candidate Countries were very similar in many respects to Cohesion Countries, we would expect valuable information regarding the **potential financial absorption of Candidate Countries** in the 2004-2006 programme period. Later in our paper, we compare the results with financial allocations in the programme documents of some Candidate Countries.

Third, we will examine whether there are different shares of the financial categories '*EU Funds*' and '*national funds*' and their components in the CCs compared to Non-CCs. This question is based on the fact that there are different co-financing requirements in both groups of countries⁵. The results here

² Different literature sources deal with absorption capacity. We can find two groups: (1) *macroeconomic analysis*, such as by **Herve/Holzmann (1998)**; and (2) *different evaluation studies and reports* prepared and published by the European Commission or by consultants working in charge of the Commission. The concepts we refer to in this paper were developed by **NEI (2002a-c)**. In **Mrak (2003)** we can find following definition: "The concept of absorption capacity is, in fact, composed of two components. The first one, called »institutional capacity«, is a capacity of a country to prepare and manage projects and programmes to be financed from the EU budget. The second component of the country's absorption capacity is its »financial capacity« to provide local co-financing for EU sponsored projects and programs. The latter will be also used in the case of this paper.³ Here, we note that we are concentrating our paper on the question of financial absorption rates for Structural Funds of the EU. Hence, we will not discuss the problems of the development literature dealing with bilateral and multilateral aid to development countries.

⁴ See **Council Regulation (EC) No. 1260/1999** of 21 June 1999 laying down general provisions on the Structural Funds, Official Journal of the European Communities.

⁵ To our knowledge, there are no formally stated country-based discriminatory requirements in the General Regulation for Objective 1 countries or regions. The General Regulation foresees an EU co-financing rate of up to 75% of total funds (EU + national) for Objective 1 areas. In the case of the Cohesion Fund the co-financing rate even extends to 80-85%. However, those Objective 1 regions that are part of a relatively wealthy country, such as Burgenland in Austria, receive much lower co-financing from the EU than, for instance, Cohesion Countries.

should provide information on how the relative share of these two categories can ultimately influence the financial absorption of a particular country or group of countries. Putting it simply: ***which financial components are ‘more easily’ absorbed and, consequently, what lessons regarding the potential “allocation trap” for the New Member States could be drawn here?***

At the end we would like to compare our results with the situation in the programming documents of some of the new Member States and make respective conclusions.

Ex-Post Evaluation of Objective 1 1994-1999

In mid-July 2003 the European Commission presented the Ex-Post Evaluation of Objective 1 1994-1999 (see **Ex-Post Evaluation 1994-99, 2003, Annexes**). For those Member States and their regions eligible for the Objective 1 type of financial support a very detailed analysis was prepared presenting different aspects of the Structural Policy in the most economically lagging behind areas of the European Union. The Ex-Post Evaluation (hereinafter: *the Evaluation*) was strongly policy-focused and addressed the following elements:

1. to assess the ***appropriateness of the strategies*** adopted and implemented in Objective 1 regions and the coherence of the approach at the EU level across the entire Objective 1 area;
2. to analyse ***effectiveness***, namely, the achievement of objectives set out in the programming documents based on the results;
3. to analyse the ***efficiency*** of the implementation of large projects supported in Objective 1 regions;
4. to assess the ***impact*** of the Structural Funds on economic and social cohesion;
5. to make an appraisal of the effectiveness of ***management and implementation*** systems for those programmes co-financed by the Structural Funds;
6. to assess ***Community Added Value*** achieved in Objective 1 regions between 1994 and 1999; and
7. to learn ***lessons for current and future programming*** or implementation of Objective 1 programmes, and to identify longer-term implications of the evaluation’s findings for the Structural Funds after 2006 in the context of enlargement.

In general, *the Evaluation* represents a full range of valuable information that is used in various parts of this paper. In particular the Evaluation’s sub-chapters such as management and implementation systems and lessons for future programming and enlargement have been of great benefit to it. Unfortunately, a look at the comprehensiveness and quality of the Evaluation shows almost no attempt to study different forms of absorption capacity in Objective 1 areas. Apart from some valuable information regarding the effectiveness of different management arrangements and management styles, we can hardly find any attempt to draw conclusions on absorption. Therefore, by using the financial data from the study we seek to calculate the financial absorption levels of Objective 1 areas.

The Approach and Problems with Data

Our approach in this paper is to calculate the financial absorption of EU-related development funds by comparing planned and actual expenditures in Objective 1 areas in the 1994-99 period. We made calculations for the totals (all Objective 1 areas) for two groups of Objective 1 areas, namely Cohesion Countries and Non-Cohesion Countries, as well as calculations on a country-by-country basis. In addition, calculations for each financial component were also made. Since the Evaluation did not

provide enough data for the Cohesion Fund, the calculations were only carried out for the four Structural Funds⁶.

In 1994, 10 Member States were eligible either in whole or part for support under Objective 1 of the Structural Funds. In 1995, following Austria's accession to the EU the total number increased to 11 countries⁷. *The Evaluation* categorises and evaluates Objective 1 regions according to the criterion of their effective size.

Due to the specific aim of our paper, we decided on a different, much simpler, categorisation of Objective 1 Member States and their regions. In order to receive as much as information possible regarding financial absorption of Structural Funds in Member States, we wish to also use this information as a learning experience for the new Member States. By splitting Objective 1 countries between **Cohesion Countries** and **Non-Cohesion Countries**, we believe we will move closer to achieve this aim.

Financial sources can be split into two categories; '*EU funds*' and '*national funds*'. However, we also carry out calculations for each category's components separately. The EU funds have four components: the European Regional Development Fund (ERDF); the European Social Fund (ESF); the European Agriculture Guarantee and the Guidance Fund (EAGGF); and the Financial Instrument for Fisheries Guidance (FIFG). Within the 'national' category there are two components ensuring the necessary co-financing proportions: first, '*Other public*'⁸ meaning co-financing from respective national budgets and, second, the component '*Private*' meaning the private sector's co-financing participation in a particular Objective 1 development programme. In the last part of this paper we calculate financial absorption capacity for two groups: in the first group we find 'All funds' (EU and national), and in the second group ('Structural Funds') only EU funds are involved.

The financial data presented here are the planned and actual expenditures in Objective 1 areas in the period 1994-99. Under *planned expenditure* are data from the programming documents agreed between a Member State and the European Commission for the 1994-99 period. In the Evaluation, planned expenditure is expressed in current 1994 prices. However, the biggest problems in the Evaluation (and in our paper, consequently) relate to the *actual expenditure* data and can be summarised as follows:

1. Actual expenditure presented in the Evaluation was at current 1999 prices, while planned expenditure was at current 1994 prices. Therefore, we calculated the actual data by using a country-specific GDP price index in order to arrive at constant prices in 1994 for both planned

⁶ For the 1993-1999 period, the budget of the Cohesion Fund amounted to €15.5 billion. (see **Ex-Post Evaluation 1994-99, 2003**: 54)

⁷ In four cases the programming area covers the *whole* (**Ireland, Greece, Portugal**) or most (Spain) of the Member State's *territory*. For **Spain** almost 60% of the country's population living in 11 regions was eligible for Objective 1 actions: Andalusia, Asturias, Cantabria, Castilla y Leon, Castilla-La Mancha, Ceuta y Melilla, Comunidad Valenciana, Extremadura, Galicia, Canarias, and Murcia. In three cases, Germany, Italy and Northern Ireland (UK), Objective 1 areas formed *macro-regional programmes*. In **Germany** Objective 1 programmes were prepared for the five New Länder (Brandenburg, Sachsen, Sachsen-Anhalt, Mecklenburg-Vorpommern, Thüringen) and East Berlin, and in **Italy** for the regions Abruzzo (only from 1994 to 1997), Basilicata, Calabria, Campania, Molise, Puglia, Sardegna, and Sicilia. Because of its size, Northern Ireland was also treated as a macro-region. In Austria, Belgium, the Netherlands, France and the UK one or more regions were the focus of individual programmes, forming a *micro-regional programmes*. Individual programmes were prepared for Flevoland in the **Netherlands**, the Province of Hainaut in **Belgium**, and for Burgenland in **Austria**. In the **UK**, micro-regional programmes were prepared for Merseyside, and Highland & Islands, and in **France** for the overseas departments, Corsica and the districts of Valenciennes, and Douai et Avesnes.

⁸ *Public expenditure* in the financial tables of a development document such as the Community Support Framework are split into the categories 'Community grants' and 'National public financing requirements'. The first category represents allocations for all four Structural Funds, the second category represents national public components such as central government, regional and local and other expenditure. Therefore, we are speaking of the 'Other' public expenditure, meaning 'other' than that of the EU.

and actual expenditure (see *Annex 1*). Consequently, all our calculations are in constant 1994 prices.

2. In the case of Non-CCs, the sum of totals by countries involves estimated expenditure and does not correspond to the sum of the particular components of a respective country. For the UK, Germany and France the estimated total sum is higher than the sum of their components (see *Annex 2, Table A3*). In most cases here, data for some regions is missing. Contrary cases can be observed for Italy and Austria, where the estimated total sum is lower than the sum of all components together (see *Annex 2, Table A4*). For Italy, the change of government policy could be an explanation. While the totals are different from the sum of all components, the sum of actual components still makes up more than 80% of the particular total. Only for the Netherlands and Belgium, and for all the CCs, do the estimated totals equal the sum of components actually spent⁹.
3. Most of the missing or incomplete data are for the categories 'Other Public' and 'Private'. Therefore, we can hardly rely on the calculations in terms of financial absorption when these two categories are involved.
4. Another technical problem we can observe relates to point 1 above, namely, with the calculations in constant prices. The programming period officially ended in 1999 but actual expenditures were executed even up to three years later. While the country data for actual expenditure in Austria and Germany is the public expenditure committed by 31st December 1999, for Italy and Ireland the actual expenditure data are as at 31st December 2001. In paper, we calculated all expenditure under the component 'actual' in 1999 by using a country-specific price index.
5. Since the Evaluation does not provide information split into: allocations, commitments and payments, like this is applied for instance in case of Pre-accession Instruments in new Member States, we cannot differentiate between commitments and payments. The data provided under 'actual expenditure' was sometimes based on reported commitments and sometimes on reported payments. However, taking these limitations into account we have to assume that funds committed at the end of 1999 will also be paid up to two or three years later.

⁹ However, in Ireland actual expenditure under the Hospital Infrastructure OP was not included in the total. The figures accounted for 1.5% of total planned ERDF expenditure and 3.8% of total planned national expenditure. Also see **Annex 3, Notes**.

Relative importance of financial components for financial absorption

In the analysis of Cohesion Countries and Non-Cohesion Countries we will proceed as follows; first, we show the relative shares of planned and actual financial allocations by components and by groups of countries. We then present financial absorption rates for both groups and for the totals.

We do this for both the case when all financial components are included and then for the case where only Structural Funds' components are included.

When we calculated financial absorption rates we were also interested in the relative share of each component and its potential influence on the overall picture. Such an approach enabled us to study more in depth the reasons underlying possible differences between particular financial components.

The strong influence of 'national' components

In **Table 1** we see the relatively high representation of both planned and actual expenditure of the 'national' components, especially the 'Private' component. Both components together make up more than 45% of planned and 40% of actual expenditure in CCs and more than 65% of planned and almost 60% of actual expenditure in Non-CCs.

In the Non-CC group the share of 'Private' comprises almost 44% of total planned expenditures and close to one-third (27.6%) of actual expenditure. Looking at the even more aggregated level of these two country groups together, within planned expenditure the 'Private' component takes the highest share (32.6%), while for actual expenditure the share of this component drops by almost one-half (18.8%).

The results of **Table 1** show that expenditures by the private sector were too optimistically planned in both groups of countries, because the figures on the shares of actual expenditure are much lower than the planned ones. However, the contribution of actual expenditure from the private sector in Objective 1 regions in more developed Member States is still almost three times higher than in Cohesion Countries.

Table 1: Objective 1 Expenditure in 1994-99; All components

in %

	<i>Expenditure</i>	EU Funds				National Funds		Total
		<i>ERDF</i>	<i>ESF</i>	<i>FIFG</i>	<i>EAGGF</i>	<i>Other Public</i>	<i>Private</i>	
CCs	<i>Planned</i>	32.5	12.2	1.2	7.4	24.8	21.8	100
	<i>Actual</i>	37.7	14.2	1.2	7.8	29.0	10.0	100
NON-CCs	<i>Planned</i>	18.4	7.9	0.4	5.3	24.2	43.8	100
	<i>Actual</i>	20.5	8.8	0.4	5.9	31.4	27.6	95*
TOTAL	<i>Planned</i>	25.6	10.1	0.8	6.4	24.5	32.6	100
	<i>Actual</i>	29.2	11.5	0.8	6.8	30.2	18.8	97*

Note:

* Total figures of less than 100 reflect the difference in the estimated and available data.

Source: Ex-Post Evaluation (2003, Annex)

We can also see changes in the relative shares of financial components between planned and actual expenditure. When comparing the planned and actual expenditure shares of the ‘Other Public’ component we see an increase in actual expenditure. Quite substantial increases in ‘Other Public’ in both groups of countries can be observed. In the case of Non-CCs the increase in actual expenditure amounted to more than 7 percentage points (see **Table 1**)¹⁰.

The opposite case is registered in the ‘Private’ component. In both groups of countries the share of ‘Private’ in actual expenditure was substantially lower than in planned expenditure. However, after the ‘Other Public’ component in actual expenditure, the relative share in Non-CCs still makes up the second biggest financial component (27.6%). In CCs, in terms of its share the ‘Private’ component was pushed from third to fourth place among all components, comprising just 10% of all actual expenditure in this group of countries.

Each financial absorption rate depends on the components involved

Table 2 shows that those components with the highest shares in actual expenditure from **Table 1** such as ERDF and ‘Other Public’ are also the components with the highest financial absorption rates. In both country groups, the highest absorption figures can be stated for the ‘Other Public’ component. The total figures for financial absorption are slightly higher in the case of Non-CCs (75.4%) than in the case of CCs (73.4%) (see **Table 2**).

Table 2: Financial Absorption in Objective 1 in 1994-99 – All components

in MEUR, Prices 1994

	<i>Expenditure</i>	Total	EU Funds				National Funds	
			<i>ERDF</i>	<i>ESF</i>	<i>FIFG</i>	<i>EAGGF</i>	<i>Other Public</i>	<i>Private</i>
CCs	<i>Planned</i>	114,044	37,097	13,921	1,397	8,450	28,301	24,875
	<i>Actual</i>	83,720	31,603	11,914	1,009	6,531	24,318	8,342
	Absorption (%)	73.4	85.2	85.6	72.2	77.3	85.9	33.5
NON-CCs	<i>Planned</i>	110,377	20,334	8,715	421	5,872	26,664	48,371
	<i>Actual</i>	83,172* (78,614)	17,072	7,297	301	4,867	26,125	22,952
	Absorption (%)	75.4 (71.2)	84.0	83.7	71.5	82.9	98.0	47.4
TOTAL	<i>Planned</i>	224,421	57,431	22,636	1,818	14,322	54,965	73,246
	<i>Actual</i>	166,892* (162,332)	48,675	19,211	1,310	11,398	50,444	31,294
	Absorption (%)	74.4 (72.3)	84.8	84.9	72.1	79.6	91.8	42.7

¹⁰ In order to avoid confusion here, we make a small reminder. Namely, when discussing the results of **Table 1** we must not forget we are talking about ‘shares’ and not about absolute values. Therefore, when the share of the ‘Other Public’ component in the section actual expenditure increased, we must note that in absolute terms actual expenditure was still less than the planned figure. However, on this assumption financial absorption rate in this component was below 100%.

Note:

*This figure is an estimation of total actual expenditure as provided by the Evaluation. The figures in brackets are calculated as an accumulation of the registered actual amounts of all financial components. Were our financial absorption calculations to be based on the figures in the brackets, absorption levels would be lower (71.2% instead of 75.4% in the case of Non-CCs, for instance).

Source: Ex-Post Evaluation (2003, *Annex*)

Unfortunately, due to the technical reasons of uncompleted data for ‘national components’, we can hardly make any reliable conclusions about financial absorption rates where ‘All funds’ are taken into consideration. Namely, the high participation of ‘Other Public’ within actual expenditure can be attributed to the technical reason that the ‘Private’ component was not presented separately but simply added to ‘Other Public’.

Therefore, we have to rely on data where ‘national’ components are excluded. Looking at the data for Structural Funds only, excluding the categories ‘Other Public’ and ‘Private’ expenditure, the data set is much more complete. Further, the relative shares also added up to 100% for actual expenditure in both groups of countries, which was not the case when we compared both ‘national’ components. Consequently, **the values for financial absorption measured without national funds are much more reliable.**

Table 3: Financial Absorption in Objective 1 in 1994-1999 – Structural Funds

in MEUR, Prices 1994

<i>Expenditure</i>		ERDF	ESF	FIFG	EAGGF	TOTAL
CCs	<i>Planned</i>	37,097	13,921	1,397	8,450	60,865
	<i>Actual</i>	31,603	11,914	1,009	6,531	51,057
	Absorption (%)	85.2	85.6	72.2	77.3	83.9
NON-CCs	<i>Planned</i>	20,334	8,715	421	5,872	35,342
	<i>Actual</i>	17,072	7,297	301	4,867	29,537
	Absorption (%)	84.0	83.7	71.5	82.9	83.6
TOTAL	<i>Planned</i>	57,4310	22,636	1,818	14,322	96,207
	<i>Actual</i>	48,675	19,211	1,310	11,398	80,595
	Absorption (%)	84.8	84.9	72.1	79.6	83.8

Source: Ex-Post Evaluation (2003, *Annex*)

In **Table 3**, values for financial absorption without the ‘national’ components are presented. Here, both groups of countries achieved quite similar absorption figures, with slightly higher absorption rates seen in the CC group. We see that, in total, both groups of countries had to manage almost € 100 billion of planned expenditure over the whole period, with CCs having a share of more than 60% of total funds.

Here, financial absorption rates in CCs and Non-CCs in the 1994-99 programme period were close to 84%, the highest rates were again registered for the components ESF and ERDF, and the lowest for the FIGG and EAGGF.

Despite the limitations identified when dealing with the financial components of the category 'national' funds, in this sub-chapter we discuss the relative high shares of 'national' components in the Non-CC group and in the overall picture of the programmes. Later on, some conclusions are drawn regarding this discussion. In order to obtain some answers, we rely on the elements of the *New Growth Theory* (see e.g. **Romer, 1986; Lucas, 1988; Grossman/Helpman, 1991**). Those elements should be taken on board when dealing with some CCs such as Ireland, where decisions on investment priorities were directed to human resource development, and the *importance of the private sector's involvement* in development policies can be recognised in all Objective 1 development programmes. Some results will be interpreted with the help of an awareness the Structural Funds' principles, especially those of programming and partnership.

In our discussions here we will *first* discuss the importance of the high share of 'national' funds, especially the participation of the 'Private' component. *Second*, we will search for reasons why the share of actual 'Private' expenditure was much lower than the share of planned expenditure. Here, the principle of the Structural Funds will be discussed, namely, the partnership principle and relative to that the consultation process.

Discussion 1: The high shares of planned 'Private' and 'Other Public' expenditure

We registered the higher participation of the category 'national' funds in Non-Cohesion Countries, particularly the financial component '*Private*'. What could offer an explanation of this?

One possible explanation for the relatively high planned 'Private' expenditure is found in the fact that Objective 1 regions of this group belong to relatively wealthier EU Member States with a strongly developed private sector. Here, EU funds should be used to additionally activate the private sector investments of a country in economically lagging behind Objective 1 regions. According to this explanation, factor mobility towards poor regions should be encouraged by the Structural Funds and the private sector should play a very substantial role in this process. Accordingly, a catching-up process and the contribution to the overall objective of achieving real convergence between the regions of a particular Member State is expected to be achieved.

Possible reasons for big differences seen between actual and planned 'Private' expenditure are discussed below.

In addition, in both groups of countries we can register very *high proportions of the 'Other Public'* component. For the CCs this proportion even expanded when comparing planned with actual expenditure¹¹. **An explanation** for the relatively strong increases seen in the component 'Other Public' should be looked for in the composition of the category 'national funds' itself. This category has two components, national public (budget) and private funds, respectively. However, for the European Commission (the *principal*) it is only important that the co-financing shares or 'national'

¹¹ However, this interpretation is only valid on such an aggregated level of two country groups and is put in question when observing the level of particular countries. In *Annex 2, Table A1* shows an increase in respective shares of actual expenditure in all financial components, with the exception of 'Private', in all CCs. In the Non-CC group, *Annex 2, Table A3* shows very different directions in particular countries; in some countries such as Belgium and Austria the shares of actual 'Private' expenditure increased and the share of actual 'Other Public' expenditure dropped in most Non-CCs. We can hardly find an explanation for these results from the data alone; however, we reiterate the technical problems with the actual expenditure data set.

funds agreed in the respective Community Support Framework or Single Programming Document are ensured during the execution of a development programme. Because neither the Commission nor a Member State (an *agent*) can ensure that the planned 'Private' participation will be 100% met (or whether the 'Private' share will be higher than agreed), only the respective national budgets are any real assurance of the national co-financing shares. At the end of the day, each Member State has to guarantee appropriate execution to the Commission¹².

Therefore, in to our opinion the 'Other Public' component in a particular Cohesion Country will always have to replace the missing 'Private' co-financing in order to keep the financial construction of a programme valid and not to lose the EU funds. This situation is the most evident in the Cohesion Countries.

Nevertheless, another conclusion here is that the actual 'loss' in the 'Private' component observed mainly in Cohesion Countries has been greatly compensated for by the national budgets of respective Objective 1 Member States and not by reallocations between other components. In order not to conflict with the additionality principle¹³, it would hardly be possible to make any shifts of funds between the group of 'EU components' and the group of 'national components'; not in favour of the 'EU components' nor in favour of the 'national components'. Therefore, the only possible shifts might be between particular components within each of the two categories; either 'EU funds' or 'national' funds.

We thus comment on shifts of relative shares between planned and actual components;

- in order to compensate for the lower absorption of EAGGF and FIFG components actual expenditure would have to be moved from these two components to the ERDF and ESF components during the programme period; and
- in order to ensure the additionality rules in the 'national' funds category, to compensate for the low actual participation rate of the 'Private' component additional funding from the national budgets would have to be activated.

We can see that we must deal here with the problem of budget restructuring in EU member states. Here, a large majority of national budget expenditures funded from the EU budget – Structural funds and the Cohesion fund, as well as resources for rural development – requires co-financing from national resources. Obligation to provide national co-financing in fact means that a country has to channel additional national budget resources for expenditures eligible for EU budget financing.

¹² See **Council Regulation (EC) No. 1260/1999**; Title IV: Effectiveness of Assistance from the Funds.

¹³ **Council Regulation (EC) No. 1260/1999**, Article 11, point 1. states: "*In order to achieve a genuine economic impact, the appropriations of the Funds may not replace public or other equivalent structural expenditure by the Member State*". This means that EU member states are not allowed to use structural funds to finance projects that, in the absence of this transfer, would have been financed from the national budget.

Low interest of Private sector – a need for restructuring of national budgets?

Taking example of new Member States in his paper **Mrak (2003)** describes a general issue of intra-budgetary financial flows when EU funds are coming into a national budget forcing the national authorities to deal with the change of structure of budget expenditures. Further, he sees three *Alternatives* that could occur under such conditions:

- ***Alternative A***; if a country is absolutely committed to keep its budgetary balance unchanged and wants to use all EU resources available then ***it will have to restructure its national budget expenditure*** in order to meet requirements of both: additionality principle and co-financing principle. This will lead to a growing proportion of funds channelled towards EU eligible investments.
- ***Alternative B***; if a country wants to use all EU budget resources available, but, on the other hand, is either not willing or not able to make restructuring of its budget expenditures, this country will have to increase the overall level of budget expenditures (in order to meet additionality and co-financing of the EU eligible expenditures). This country will run into a budget deficit.
- ***Alternative C***; here, a country deals in contrast to the above two alternatives, namely, it is not committed to draw EU funds and consequently have favourable net balance *vis-à-vis* the EU budget. This could occur for two reasons: first, a country simply does not pay attention to the drawing of EU resources or, second, it is lacking sufficient absorption capacity. This **Alternative Mrak (2003)** splits into two variants, the first where a country is not willing/able to restructure its budget, and the second where it is willing/able doing that. The first variant would lead a country into a worst scenario of double deficit: it will enter into a budget deficit and at the same time it will become a net payer to the EU budget. If, however, the country embarks on budget expenditure structural changes - the second variant - than it has a chance to escape the budget deficit but will nevertheless experience net outflow of funds to the EU budget.

Whereby **Mrak (2003)** in his paper deals with a potential – and very realistic – need for restructuring of national budget expenditure due to inflow of EU funds, we would like to discuss the issue of what influence on budget could have potential low absorption rates of Private sector claimed in our paper. The question is, what would be reaction of a particular government in case of low interest of business sector for its participation in EU programmes?

There is no doubt that, if a country wants to use all EU budget resources available it will have to find replacement for missing Private funds. However, an interesting question is where do these additional budget funds could come from? In our opinion, there are just two possibilities. **First**, governments raise additional funds by expanding their respective budget deficits and, **second**, governments internally restructure their national budget items by taking the ‘missing’ private funds from programmes not involved in EU co-financing (i.e. military, foreign affairs etc.).

Because of annual reports to the Commission regarding its economic policy – in order to meet criteria of Stability and Growth Pact - the first situation is not very likely. However, the second case is much more possible to happen. Consequently, national (budget plus private sources) structural spending cannot diminish but has to be restructured to cover co-financing needs. Support for this statement can be found also in **Landesmann/Richter (2003: 9)** when quoting **Backe (2002: 153)**.

However, there is also a **third** possibility for a particular government, namely, the government could make an arrangement with the Commission and not accept EU funds. This is also not very likely from domestic political reasons.

For future research one should look at “development parts” of national budgets of particular Member States. There, one should see, (1) what parts of those budgets are already involved in additionality and co-financing “activities”, and (2) is there any potential space for funds in case of low absorption capacity of Private sector.

Higher participation rates of Private sector in wealthier countries

Wealthier EU members use the Structural Funds to further mobilise their respective ‘development parts of budget’ (‘national’ funds) as well as the private sector. We can also express this with the statement that business in a wealthy country values grants much more than business in a poor country. Therefore, in the first case business is already satisfied with the very small share of monies granted as part of a project’s total value, while in the case of Cohesion Countries the share of an EU grant must be substantially higher in order to encourage the business sector to invest.

However, there may be two other reasons for more the ‘active’ private sector in Non-CCs. *First*, in Non-CCs implementation capacity is simply higher than in CCs, and businesses are more aware of the fact that public support will automatically increase the rate of return on their investment. This is reflected in a developed business sector. *Second*, in Non-CCs’ private sectors EU funding is much more often used for projects that would in any case be financed – even if there were no EU funds. This increase in absorption is simply based on a bigger supply of the private sector’s programmes.

From the public choice literature on absorption capacities for investments, we can read that information disadvantage of the transfer-disbursing authority enables the private sector to reap economic rent. The results in this paper show that this information asymmetry may be bigger in Cohesion Countries than in Non-Cohesion Countries.

Important to be mentioned here are also *timing-related problems*, where there is a certain time lag between an investment and an increase in output. **Barro and Sala-i-Martin (1995)** introduced the opportunity costs of investment (as measured by reduced consumption in the meantime) into growth theory. Economic output reacts faster in response to the installation of private productive capital than to the installation of infrastructure or creation of human capital. The returns on investment may take time to materialise, especially for productive inputs like physical infrastructure or human capital. This is because private sector investment decisions will only be affected once the build-up of infrastructure and human capital has reached a certain level¹⁴. This means that the opportunity costs of Structural Funds investment decisions may be high and such transfers may delay private investment decisions by increasing uncertainty and/or modifying expectations. Despite the fact that EU funds can achieve a higher return in richer EU countries, this does not speak against the transfers. On the contrary, this is the main justification for public intervention.

Another issue related to time is that the option of delaying investment is in principle not envisaged in European practice (see **Herve/Holzmann, 1998**: 90). Accordingly, countries which are unable to spend the transfers on investment projects during a specific year are judged to have an absorption problem. The recipients have a strong incentive to spend the money on an investment project that may be sub-optimal, which may also tend to reduce the quality of projects. This problem is exacerbated by the fact that the overall amount of Structural Funds allocated to a country is exogenously given as a result of political bargaining and some kind of ‘first come – first served’ behaviour of the principal can hardly be avoided (in this case of the public authority, such as Managing Authority). Agents presenting their projects earlier seem more professional and have more time to lobby the principal and, consequently, to reap a higher share of the allocated transfers¹⁵.

¹⁴ **Nijkamp and Blaas (1995)** estimated that, to measure the impact of public infrastructure creation on private investment at the regional level, the best empirical time lag was four years. Increasing average human capital through better education may take half a generation; infrastructure projects will only affect private investment once the projects are completed. Moreover, **Gaspar and Pereira (1995)** assumed adjustment costs for private capital to be only half the amount of adjustment costs for public infrastructure and human capital. However, we believe that not only the time lag, but also the share of the particular investment category, significantly influences the absorption of these funds.

¹⁵ The phenomenon known as the ‘rat-race’, where the overall amount of transfers can be seen as a given piece of cheese and rent-seeking economic agents behave like rats racing to obtain the largest share possible, was described in **Akerlof (1976)**. In the case of Structural Funds, this phenomenon is likely to occur at the level of Operational Programmes (in the case of CSF) or Single Programming Documents and concerns both public and private agents who compete against each other in asking for co-financing support from the EU.

Country Analysis without 'National' Components

Here we discuss the results without the components 'Other Public' and 'Private'. The reasons for this mainly involve missing data or even mistakes in the Evaluation relating to these two components when looking at the actual expenditure data. Despite this, calculations with all components are also presented in *Annex 2*. The country analysis should provide us with the following information. *First*, what are the differences in the relative shares of components between particular countries in the CC and Non-CC group, respectively and, *second*, what is the financial absorption of respective Member States.

Strong involvement of the ERDF component

In **Table 4** we see the relative shares of the 'EU components' in Cohesion Countries. We see that *Ireland* and *Greece* had the most contrary decisions about their respective investment allocations. While Ireland's share of ESF measures was the highest and the share of the ERDF the lowest among the CCs, Greece invested the most through ERDF and the less through ESF measures. However, all CCs invested most through the ERDF measures. In Ireland, the highest share of the EAGGF component is also observed among the CCs.

With the exception of *Greece*, in the CCs no big changes can be observed between planned and actual expenditure when considering EU components alone. In Greece, a relatively strong shift from the planned 66% to the actually spent 69.4% of ERDF expenditure should be noticed, mainly because of the lower actual expenditure of the EAGGF component (from 14.6% planned to 11.9% actual expenditure). Accordingly, Greece devoted almost 70% of its actual expenditure to ERDF measures and only 18% to ESF measures.

Most CCs (with the exception of Ireland) devoted more than 60% of 'EU funds' to the ERDF measures, which is far more than with most Non-CCs.

Table 4: Expenditure in Objective 1 Cohesion Countries in 1994-99*in %*

<i>Expenditure</i>		ERDF	ESF	FIFG	EAGGF	TOTAL
Portugal	<i>Planned</i>	62.4	22.5	1.5	13.5	100
	<i>Actual</i>	63.7	23.3	0.1	13.0	100
Spain	<i>Planned</i>	60.6	23.0	3.8	12.6	100
	<i>Actual</i>	60.6	23.7	3.8	11.9	100
Ireland	<i>Planned</i>	45.2	35.0	0.8	19.0	100
	<i>Actual</i>	45.1	35.3	0.8	18.8	100
Greece	<i>Planned</i>	66.0	18.5	0.9	14.6	100
	<i>Actual</i>	69.4	17.9	0.8	11.9	100

Source: Ex-Post Evaluation (2003, *Annex*)

Table 5 presents the relative shares of the ‘EU components’ in Non-CCs. While in CCs (**Table 4**) the respective country shares of the components between planned and actual expenditure did not change a lot (with the exception of Greece), in Non-CCs much bigger differences can be identified. Comparing the shares of planned and actual expenditure, in the *UK*, *France* and *Belgium*, respectively, we can notice a strong shift towards an increase of actual ESF shares in these countries on one side, and a decrease of actual shares of the ERDF component, on the other. The strongest increase in the ESF share can be observed in the UK, namely, from 31.7% of planned to 38.8% of actual expenditure. While in Germany the figures remained stable, in the *Netherlands*, *Italy* and *Austria*, respectively, the relative share of actual expenditure moved towards an increase in the ERDF component and a drop in the ESF.

With the exception of Italy, Belgium and Austria, all other Non-CCs devoted less than 60% of their ‘EU components’ to the ERDF funds, which is far less than with the CCs (with the exception of Ireland, however).

Table 5: Expenditure in Objective 1 Non-Cohesion Countries in 1994-99*in %*

	<i>Expenditure</i>	ERDF	ESF	FIFG	EAGGF	TOTAL
UK	<i>Planned</i>	56.4	31.7	1.5	10.4	100
	<i>Actual</i>	48.1	38.8	1.6	11.4	100
Germany	<i>Planned</i>	50.0	30.0	0.6	19.4	100
	<i>Actual</i>	50.0	30.2	0.5	19.4	100
France	<i>Planned</i>	54.5	24.0	1.8	19.7	100
	<i>Actual</i>	49.3	30.4	0.8	19.5	100
NL	<i>Planned</i>	52.8	26.4	13.8	6.9	100
	<i>Actual</i>	56.8	20	14.4	8.8	100
Italy	<i>Planned</i>	65.0	18.4	1.6	15.0	100
	<i>Actual</i>	69.1	15.4	1.5	14.0	100
Belgium	<i>Planned</i>	70.6	22.9	0.1	6.4	100
	<i>Actual</i>	68.1	25.1	0.1	6.8	100
Austria	<i>Planned</i>	65	20	0	15	100
	<i>Actual</i>	65.3	19.9	0.0	14.8	100

Source: Ex-Post Evaluation (2003, *Annex*)

Since there are no similar orientations of planned and actual expenditure by component and by country in both country groups we can hardly make any conclusion about Member States' respective differences in decisions to invest in infrastructure (mainly the ERDF)¹⁶ rather than in human resources (ESF), and vice versa.

However, from the above discussions and with the help of **Table 6** and **Table 7**, we may conclude that shifts in any direction are based on the desire of each Member State to achieve the higher financial absorption of EU funds. Accordingly, those Non-CCs that increased their share of actual ERDF expenditure, such as *the Netherlands, Italy* and *Austria*, might be relatively better equipped to implement ERDF rather than ESF measures, while *the UK, France, and Belgium* might have relatively better management structures for the implementation of ESF measures.

¹⁶ In the case of the ERDF, not only is investment in (business-related) infrastructure assigned as potential activity but so too are training-related activities supporting the enhancement of a competitive environment. However, the latter activities make up only a small proportion of the overall ERDF activities.

Financial absorption rates are higher in Cohesion Countries

Among the Cohesion Countries (see **Table 6**) the country with the highest financial absorption is Spain (86.5%)¹⁷, while the country with the lowest is Greece (78.8%). Ireland and Portugal also had financial absorption values well above 80%. In the case of Non-CCs only Germany and Austria achieved absorption rates of above 90%¹⁸, all other Non-CCs had absorption levels of even less than 80%.

With the exception of Greece, the financial absorption of the ESF component was only slightly higher than that of the ERDF component in the Cohesion Countries. However, in Greece only the ERDF component achieved financial absorption above 80%, with all other components reaching absorption levels far below 80%; in the case of the EAGGF the absorption was just 64.7% (see **Table 6**).

Table 6: Absorption in Objective 1 Cohesion Countries in 1994-1999

in MEUR, Prices 1994

<i>Expenditure</i>		TOTAL	ERDF	ESF	FIFG	EAGGF
Portugal	<i>Planned</i>	13,978	8,723	3,148	213	1,894
	<i>Actual</i>	11,704	7,451	2,726	8	1,519
	Absorption (%)	83.7	85.4	86.6	4.0	80.2
Spain	<i>Planned</i>	26,300	15,944	6,047	995	3,314
	<i>Actual</i>	22,760	13,801	5,388	861	2,712
	Absorption (%)	86.5	86.6	89.1	86.5	81.8
Ireland	<i>Planned</i>	5,581	2,523	1,953	47	1,058
	<i>Actual</i>	4,772	2,151	1,686	40	896
	Absorption (%)	85.5	85.3	86.3	84.3	84.7
Greece	<i>Planned</i>	15,006	9,907	2,773	142	2,184
	<i>Actual</i>	11,821	8,201	2,115	100	1,404
	Absorption (%)	78.8	82.8	76.3	70.7	64.3

Source: Ex-Post Evaluation (2003, *Annex*)

¹⁷ When taking all funds into considerations, with 70.2% Spain is the Cohesion Country with the lowest financial absorption (see **Table 8**). Because of the difficulties of missing data, this should confirm our decision to mainly rely on the data without 'national' components.

¹⁸ Both Germany and Austria are positive outliers in the Non-CC group. For both, the only explanation can be the very good implementation of Structural Funds in their respective regions. Further, in the case of Germany the New Länder can very likely be treated as part of the CC group in terms of both amounts of absolute EU financial allocations and its relative economic situation.

In the *UK, Germany, France* and *Belgium* financial absorption in the ESF component was higher than in the ERDF component, while the contrary case can be observed in the *Netherlands, Italy* and *Austria* (see **Table 7**). These results confirm our above statements as to the reasons for relatively higher ERDF shares in the latter group of countries and relatively higher share of the ESF component in the former.

Table 7: Absorption in Objective 1 Non-Cohesion Countries in 1994-1999

in MEUR, Prices 1994

<i>Expenditure</i>		TOTAL	ERDF	ESF	FIFG	EAGGF
UK	<i>Planned</i>	2,360	1,332	747	35	246
	<i>Actual</i>	1,797	864	698	30	205
	Absorption (%)	76.2	64.9	93.5	84.5	83.4
Germany	<i>Planned</i>	14,864	7,432	4,459	91	2,882
	<i>Actual</i>	13,795	6,895	4,161	68	2,671
	Absorption (%)	92.8	92.8	93.3	75.1	92.7
France	<i>Planned</i>	2,189	1,193	525	40	431
	<i>Actual</i>	1,492	735	454	11	292
	Absorption (%)	68.1	61.6	86.4	28.3	67.6
NL	<i>Planned</i>	159	84	42	22	11
	<i>Actual</i>	115	65	23	17	10
	Absorption (%)	72.3	77.8	54.8	75.3	92.0
Italy	<i>Planned</i>	14,860	9,660	2,739	233	2,228
	<i>Actual</i>	11,661	8,057	1,799	175	1,630
	Absorption (%)	78.5	83.4	65.7	75.2	73.2
Belgium	<i>Planned</i>	730	516	167	0.37	47
	<i>Actual</i>	511	348	128	0.4	35
	Absorption (%)	70.0	67.4	76.7	98.6	73.6
Austria	<i>Planned</i>	180	117	36	0	27
	<i>Actual</i>	166	108	33	0	25
	Absorption (%)	92.2	92.7	91.7	0.0	90.8

Source: Ex-Post Evaluation (2003, *Annex*)

Discussion 2: Do higher financial absorption rates mean also better management of a particular fund?

We showed that when comparing CCs and Non-CCs, generally speaking, the CCs manage to achieve a higher share of ERDF measures than Non-CCs. This can be *explained* by the relatively bigger need for infrastructural investment in CCs. However, an outlier here is **Ireland** with the lowest share of ERDF measures among all Member States' Objective 1 areas and the highest share of planned ESF expenditure; in the case of actual ESF expenditure only in the UK is the share of actual expenditure higher than in Ireland. The political decision of the Irish government to invest in human capital more than other Member States reflects a belief in the growth determinants of the New Growth Theory. At the end of 1994-99 and beginning of the 2000-2006 programme period the long-term supply effects of this policy produced good results in Ireland.

We can also observe that there are shifts not only between ERDF and ESF components, but also between all four components. These shifts are much more intensive for Non-Cohesion Countries than CCs. One *explanation* for these shifts could be that through the whole programme period Member States are putting all their efforts into the search for good projects with the main goal to achieve higher financial absorption of Structural Funds. Therefore, the Monitoring Committees are moving funds with low absorption to those programmes where absorption is higher.

The results show that some Member States were achieving higher absorption with the ERDF component and others with the ESF component. Interestingly, with the exception of Greece, all Cohesion Countries achieved higher financial absorption with the ESF component. While in the CC group differences between absorption in ERDF and ESF, in favour of the ESF component, were not very big, for the Non-CCs, mainly the UK, Germany, France and Belgium these were much more dramatic. In the UK financial absorption of the ERDF component was only 64.5%, while that of the ESF component was 93.5%. In Greece, the Netherlands, Italy and Austria financial absorption of the ERDF component was higher than for the ESF component. There may be several *explanations* for these results, such as the type of programme¹⁹. However, clearly one explanation also relates to the better or worse management of a particular Structural Fund's implementation in a given Member State. In general, we can identify **better management capacities** for ESF measures in all Member States compared with the ERDF measures.

This statement might somehow contradict the opinion that so-called 'soft' measures, mostly related with ESF measures, need many more personnel for their implementation and are supposed to involve many more implementation problems than measures of the 'hard' investment type. According to this view, the absorption of soft measures should be lower (see **NEI, 2002a**). The results in our paper, however, show this is not the case for most Member States that carried out Objective 1 programmes in 1994-99. In the case of financial components with higher administrative requirements such as the ESF or EAGGF, financial absorption is, however, related with the administrative capacity for these components. When administrative capacity is sufficient, financial absorption will also be proportionally high.

¹⁹ There are different types of programmes within the ESF group of eligible activities. Some (for example, equal opportunity, gender) are relatively new and, therefore, not easily absorbed, whereas others are more well-established such as active labour policy, and their implementation is associated with much higher financial absorption rates (also see **European Commission (2003, Annex)**).

Better absorption of Structural Funds' components

In this part of the paper we bring into the discussion population size by Member State and, consequently, the per capita involvement of planned and actual expenditure in financial categories when 'national funds' are included (the category 'All funds') and excluded (the category 'Structural Funds'). When comparing these two categories, we consider shifts in the relative share of the category 'Structural Funds' between planned and actual expenditure.

The geographical balance of funding at the Member States level between CCs and Non-CCs can be broadly observed in **Table 8** and **Table 9**. On an aggregated level, both groups of countries also have quite similar population sizes, namely, around 45 million inhabitants each. However, the population numbers by country and by regions are very different; while in the case of three CCs we are dealing with whole countries, in the case of some Non-CCs such as Austria (Burgenland) and the Netherlands (Flavoland) we are dealing with Regional Development Programmes and Single Programming Documents serving the development needs of a population of less than 300,000.

Another question that arises is whether there is a *link between financial allocations in absolute terms (and on a per capita basis) and the financial absorption* on country-by-country basis. The argument may be that countries with more EU grants take better care of these funds and have higher financial absorption figures.

From the results here, however, *we could not find such a link*. For example, in the Cohesion Countries Spain was the country with the highest financial absorption of EU funds and the highest amount of planned EU expenditure, but it had the lowest per capita amounts of EU funds. At the same time, Ireland had the second highest financial absorption among the CCs, and its absolute amounts were the lowest and per capita figures the highest (see **Table 8**). The picture of Non-CCs is even more homogenous.

Both tables also demonstrate the strong contributions of planned and actual expenditure in many Member States to support Objective 1, either from national public sources or the private sector. Calculated both on a per capita basis and on a programme basis a clear pattern can be observed. In four CCs EU funds clustered around more than 50% of *planned programme expenditure*, in Italy, the UK and France it clustered around more than 40% and in Germany, Austria and the Netherlands it clustered around 20%. For *actual programme expenditures* the clusters remained the same, but the shares of EU funds in CCs increased substantially (see **Table 8**) which has, however, not been the case in most Non-CCs. Only in the UK and Germany did the share of EU funds actually spent increase in the 'All funds' category.

Table 8: All components vs. Structural Funds in Cohesion Countries

*All Funds compared with SF only
Prices 1994*

	Eligible population (in '000)	Expenditure	(1) All Funds	€ per capita (All Funds)	(2) Structural Funds (in MEUR)	€ per capita (Structural Funds)	(2)/(1)*100 (in %)
Portugal	9,868 (100%)*	<i>Planned</i>	26,678	2,704	13,978	1,417	52
		<i>Actual</i>	20,617	2,089	11,704	1,186	57
		Absorption (%)	77.3		83.7		
Spain	23,269 (58.2%)*	<i>Planned</i>	48,903	2,102	26,300	1,130	54
		<i>Actual</i>	34,340	1,476	22,760	978	66
		Absorption (%)	70.2		86.5		
Ireland	3,500 (100%)*	<i>Planned</i>	10,253	2,929	5,581	1,595	54
		<i>Actual</i>	8,450	2,414	4,772	1,363	56
		Absorption (%)	82.4		85.5		
Greece	10,209 (100%)*	<i>Planned</i>	28,210	2,763	15,006	1,470	53
		<i>Actual</i>	20,312	1,990	11,821	1,158	58
		Absorption (%)	72.0		78.8		
Total	46,846	<i>Planned</i>	114,044	2,434	60,865	1,299	53
		<i>Actual</i>	83,720	1,787	51,057	1,090	61
		Absorption (%)	73.4		83.9		

Note:

* % of national population covered.

Source: Ex-Post Evaluation (2003, *Annex*), Enlargement Papers (2001)

Here, relative to financial absorption we observe that in those Cohesion Countries with increasing shares of actual EU expenditure (category 'Structural Funds') financial absorption was also higher in this category. For instance, the share of planned EU expenditure in Spain amounted to 54% of 'All funds' and the share of actually spent 'Structural Funds' was 66%. When considering all funds, the ratio between planned and actual expenditure was 70.2% in Spain, and increased to 86.5% when only 'Structural Funds' were compared (see **Table 8**).

Table 9: All components vs. Structural Funds in Non-Cohesion Countries

*All Funds compared with SF only
Prices 1994*

	Eligible population (in '000)	Expenditure	(1) All Funds (in MEUR)	€ per capita (All Funds)	(2) Structural Funds (in MEUR)	€ per capita (Structural Funds)	(2)/(1)*100 (in %)
UK	3,414 (6.0%)*	<i>Planned</i>	5,671	1,661	2,360	691	42
		<i>Actual</i>	4,177	1,223	1,797	526	43
		Absorption (%)	73.7		76.2		
Germany	16,447 (20.7%)*	<i>Planned</i>	63,100	3,837	14,864	904	24
		<i>Actual</i>	45,771	2,783	13,795	839	30
		Absorption (%)	72.5		92.8		
France	2,546 (4.4%)*	<i>Planned</i>	5,005	1,966	2,189	860	44
		<i>Actual</i>	3,792	1,489	1,492	586	39
		Absorption (%)	75.8		68.1		
NL	217 (1.45%)*	<i>Planned</i>	844	3,894	159	733	19
		<i>Actual</i>	686	3,161	115	530	17
		Absorption (%)	81.3		72.3		
Italy	21,133 (36.6%)*	<i>Planned</i>	32,439	1,535	14,860	703	46
		<i>Actual</i>	25,865	1,224	11,661	552	45
		Absorption (%)	79.7		78.5		
Belgium	1,279 (12.8%)*	<i>Planned</i>	2,412	1,886	730	571	30
		<i>Actual</i>	1,899	1,485	511	399	27
		Absorption (%)	78.7		70.0		
Austria	269 (3.5%)*	<i>Planned</i>	906	3,368	180	669	20
		<i>Actual</i>	981	3,647	166	617	17
		Absorption (%)	108.3		92.2		
Total	45,305	<i>Planned</i>	110,377	2,436	35,342	780	32
		<i>Actual</i>	83,172	1,836	29,537	652	36
		Absorption (%)	75.4		83.6		

Note:

* % of national population covered.

Source: Ex-Post Evaluation (2003, *Annex*), Enlargement Papers (2001)

We derive the following *conclusions* from these observations:

- generally, *higher financial absorption in CCs* can be observed when comparing the planned and actual expenditure of the ‘Structural funds’ only;
- the higher share of the category ‘Structural Funds’ in the total (the ‘All funds’ category) of a programme does have a *positive impact on the financial absorption* of a programme; and
- high shares of ‘national funds’ (‘Other Public’ and ‘Private’) in a programme are *a sign of potentially lower financial absorption*.

In the next part of the paper we seek to show the situation in some Candidate Countries in terms of their respective financial allocations for Structural Funds negotiated in Copenhagen in December 2002. In relation to financial allocations for Structural Funds in these countries, we compare these allocations with the situation in Member States regarding Objective 1 1994-1999. Here, the perspectives discussed in the first part of this paper where we elaborated on the relative split between Structural Funds, on one side, and national co-financing from public and private sources in the Member States regarding Objective 1 in 1994-1999, on the other will be observed.

We will examine whether the results for the Candidate Countries enable us to draw similar conclusions regarding Structural Funds’ absorption as made for the Member States.

Absorption as a Choice of Programmes in CEE Countries

At the European Summit in December 2002 in Copenhagen the European Union finalised negotiations on the three – out of 30 – financially most intensive negotiating chapters, namely Chapter 7 (Agriculture), Chapter 21 (Regional Development and Structural Policy), and Chapter 29 (Financial and Budgetary Provisions). The ten future Member States were then able to receive indicative calculations on appropriations of commitments and payments from the EU budget in the 2004-2006 programming period.

The total financial commitments for the ten proposed new Member States amounted to EUR 40.85 billion for the next three years, namely amounts to ensure these countries avoid a possible net payer position in the first years of their membership. This is less than the sum cited in the 1999 Berlin resolution, EUR 42.59 billion, but still more than that stipulated in the Commission's Information Note of January 2002, that is EUR 40.16 billion (see **Landesmann/Richter, 2003**).

Analysis by components²⁰: Structural Funds, National, Private

In this sub-chapter we *first* present the split of the four Structural Funds in **Hungary, the Czech Republic, Slovakia, Estonia and Slovenia**, and *second* compare the Structural Funds components with the 'national' components such as 'national budget' and 'private funds' necessary for co-financing the EU funds. This should enable us to make a comparison with the Member States Objective 1 in 1994-1999.

Throughout the negotiations on Chapter 21 – Structural and Regional Policy on several occasions the Commission recommended that the Candidate Countries use the simplest possible structures when preparing their programme documents (see i.e. **Breska, 2003**, and **Boijmans, 2003**). These recommendations were, *inter alia*: (1) to concentrate limited funds and prepare only a small number of (operational) programmes; and (2) to opt for a mono-fund structure of (operational) programmes. In the above sections, we showed that these recommendations were largely followed in the Candidate Countries.

Table 10 shows the commitment appropriations by four components of the Structural Funds and by countries.

²⁰ In **Horvat (2003)** the structure is shown of the respective draft Community Support Frameworks and Single Programming Documents *as designed by Spring 2003*. In terms of absorption capacity the most important factor is a country's decision on the number of operational programmes and whether it will also implement those programmes through regional operational programmes (ROPs) or decide to implement its structural policies through sectoral operational programmes (SOPs). To a great extent the Candidate Countries followed the Commission's recommendations expressed on several occasions (see **Boijmans, 2003**; **Breska, 2003**) and transformed their respective national development priorities into only a limited number of operational programmes (in the case of CSF) and development priorities (in the case of SPD) with a mono-fund structure. Here, a 'mono fund' (as opposed to a 'multi fund') structure of an OP or development priority means that each OP/priority is financed by only one of the Structural Funds' components.

Table 10: Commitment appropriations by Structural Funds**Objective 1 2004-2006***in Hungary, the Czech Republic, Slovakia, Estonia and Slovenia**€ Mio., 1999 prices*

	<i>ERDF</i>	<i>ESF</i>	<i>EAGGF</i>	<i>FIFG</i>	<i>Total</i>
HU	1,093	355	313	4	1,765
%	61.9	20.1	17.7	0.2	100
CZ	839	294	147	6	1,286
%	65.2	22.9	11.4	0.5	100
SK	507	252	162	n.a. ⁽¹⁾	921
%	55	27	18	n.a.⁽¹⁾	100
EE	192	64	53	20	329
%	58	19	16	6	100
SI	120	69	21	0 ⁽²⁾	210
%	57	33	10	0⁽²⁾	100

Note:

⁽¹⁾ *The Slovak government source expresses values of both funds under the EAGGF. However, Slovakia will implement activities financed by the FIFG.*

⁽²⁾ *The here quoted **Slovenia SPD (2003)** does not involve the allocations for the FIFG yet, however, the **Slovenia SPD (2003b)** version agreed with the Commission in December 2003 does. Due to the low amount of foreseen appropriations and relatively high management costs of implementing two FIFG measures, Slovenia originally did not want to deal with the Fisheries at all.*

Sources: HU NDP (2003); CZ NDP (2003); SK Negotiation Mandate (2003); EE NDP-SPD (2003); Slovenia SPD (2003)

Most Structural Funds in the Candidate Countries in the sample were allocated to the **ERDF component**. The highest shares were held by the **Czech Republic (65%)** and **Hungary (62%)**, and the lowest share was observed for Slovakia (55%). These figures correspond with the strong representation of regional programmes especially in the Czech Republic, showing that regional programmes will be financed substantially from ERDF monies. This situation is very similar to the Cohesion Countries in the 1994-1999 programme period; with the exception of *Ireland* (only 45% for the ERDF).

Here countries with the highest and lowest shares of the **ESF component** among Candidate Countries are **Slovenia (33%)** and **Estonia (19%)**. In the case of Estonia, we see a strong mono-fund structure. The respective shares of both countries can be compared with those of **Ireland (35%)** and **Greece (18%)** in the period 1994-1999.

In previous parts of our paper we distinguished two categories of financial means related with Structural Policy, namely the 'EU funds' and 'national funds'. The category EU funds is composed of four components (ERDF, ESF, EAGGF, FIFG) and the category national funds of two components:

the 'Other Public' (meaning the national budget) and 'Private'. In **Table 11** we show figures for the same components in Hungary, the Czech Republic and the Slovak Republic, Estonia and Slovenia.

Table 11: Commitment appropriations by 'EU funds' and 'national funds'

for Objective 1 2004-2006

in Hungary, the Czech Republic, Estonia and Slovenia

€ Mio., 1999 prices

	<i>EU Funds</i>					<i>National Funds</i>		<i>TOTAL</i>
	<i>ERDF</i>	<i>ESF</i>	<i>EAGGF</i>	<i>FIFG</i>	<i>Total EU Funds</i>	<i>Other national</i>	<i>Private</i>	
HU	1,093	355	313	4	1,765	594	1,550	3,909
%	28.0	9.1	8.0	0.1	45	15	40	100
CZ	839	294	147	6	1,286	594	708	2,588
%	32.4	11.4	5.7	0.2	50	23	27	100
SK	507	252	162	n.a.	921	414 ⁽¹⁾	447 ⁽¹⁾	1,782
%	29	14	9	n.a.	52	23	25	100
EE	192	64	53	20	329	85	85	499
%	38	13	11	4	66	17	17	100
SI	120	69	21	0	211	128	193	532
%	23	13	4	0	40	24	36	100

Note:

⁽¹⁾ Data for Slovakian national funds are in current prices.

Sources: HU NDP (2003); CZ NDP (2003); SK Negotiation Mandate (2003); EE NDP-SPD (2003); Slovenia SPD (2003)

For **Hungary** (40%) and **Slovenia** (36%) we observe that the component '*Private*' makes up the highest share among all components in each country, while for **Estonia** (17%) this share is the lowest. This means that Hungary and Slovenia count on the strength and, consequently, the much more active participation of their private sectors in EU-related programmes than is the case in the Czech Republic and Estonia. In the **Czech Republic, Slovakia** and **Estonia** the stronger component is the ERDF, but the second strongest is again the '*Private*' component.

Conclusions and lessons learned

In the Ex-Post Evaluation Objective 1 1994-1999 planned and actual expenditure were presented, but no calculations of financial absorption were done. There are at least two possible reasons for this: *first*, the formal one, namely, the European Commission did not request in the Terms of Reference countries to calculate financial absorption; and, *second*, the Contractor, ECOTEC Research & Consulting, was aware of the limitations connected with data set available.

If it is the case that the first reason is relevant then the Commission is to be blamed for not using this great opportunity to also take a step forward in the field of measuring absorption capacities; the next chance for doing that will come with the Ex-Post Evaluations of programme period 2000-2006, presumably, in 2009. However, if the second factor is relevant then this case study at least seeks to show that some valuable information can still be interpreted from the results. We have primarily not been interested in only how 'good' or 'less good' a particular country or region has been in absorbing Structural Funds, but in identifying the reasons for the particular performance of a country, group of countries or financial component. By discussing some reasons of an institutional nature, we hope to make some valuable statements that could also be of use for new Member States.

The main conclusions and lessons learned regarding the EU-15 case are:

Absorption and the relative importance of financial components

At the level of two country groups we registered financial absorption of around 75% when all funds were included, and some 84% when the calculations were done for the Structural Funds alone. Therefore, ***no country group specific differences in financial absorption were noticed*** between Cohesion Countries and Non-Cohesion Countries.

Among Cohesion Countries the highest absorption was noted for Ireland when taking 'All funds', and for Spain when calculating for Structural Funds only. Ireland showed the best absorption results in the category 'national' funds. These results influenced the overall results the most. ***Among Non-Cohesion Countries***, in the 'All funds' category the highest absorption was detected for ***Austria and Germany***. These two countries also achieved the best results in the Structural Funds category.

The very strong participation of the 'national' category was registered. In Non-CCs the share of the 'national' category is much higher than in the CC group; however, the overall absorption of Non-CCs does not differ a lot from that in CCs.

The shares of the ERDF managed by CCs are higher than those in Non-CCs. This shows the clear development priorities favouring infrastructural investments in the CCs.

The financial absorption of 'Private' funds is better in Non-Cohesion Countries than in Cohesion Countries. A large discrepancy is noticed between planned and actual expenditure in the 'Private' component. We believe this can be reduced by institutionalising consultation process elements already at the very beginning of programme planning.

The highest absorption levels can be found in the components ‘Other Public’ and ERDF when observing the situation by country groups. However, in the case of country-by-country analysis in most Member States the highest absorption was calculated for the ESF component.

Among the Structural Funds, for the ERDF and ESF components we can claim relatively higher absorption than the EAGGF and FIFG. A better financial absorption of a particular financial component reflects a country’s better administrative capacity in that component.

Lessons learned

The main lessons learned from this case study are:

1. The involvement of planned ‘Private’ expenditure is overestimated at the beginning of a programme period. Therefore, it is an illusion in most countries that the private sector can be attracted by such high shares into a development programme. Consequently, the share of actual ‘Private’ expenditure was at least one-half less than the actual share.
2. In order to improve the absorption of the ‘Private’ component it is crucial to establish better information channels between respective governments and their partners in a country or region. In the framework of the programming process it is essential to better institutionalise the partnership and consultation process. Consultation with partners should run in parallel with the programme planning process.
3. Strong political commitment to a development programme is essential. In particular, this must be so for measures where an over-proportional number of personnel is required for Structural Funds’ management. High financial absorption in the case of the ESF provides a good example here.
4. Financial allocations in absolute or per capita terms are not an indicator of higher or lower financial absorption for EU programmes. The argument that those countries receiving bigger absolute proportions of EU funding have better financial absorption cannot be confirmed here.
5. From the standpoint of improving the financial absorption of Candidate Countries, it is advisable to concentrate development funds in those financial components where administrative absorption capacity is likely to be best. The results of on Pre-accession Instruments in **Horvat (2003; Case Study 2)** are confirmed by the findings of the highest financial absorption levels in the ESF and ERDF in this paper.

For the new Member States we found two conclusions;

1. We identified different shares of expected co-financing either from the national budget or the **private sector** in five Candidate Countries. The highest shares were reported for Hungary (40%) and Slovenia (36%). We can say that these two countries have great trust in the absorption capacity of their respective private sectors. Should this not happen and the private sector not be sufficiently attracted, we would expect pressure on the national budgets to guarantee the co-financing shares agreed in the programming documents between the European Commission and the respective countries.

2. Our last observation concerns the relative shares of **EU funds in the total** financial construction of countries. Slovenia and Hungary, with 40% and 45%, respectively, have the lowest share of EU funds in the financial tables of their respective programme documents. The low shares of EU funds can be seen to have a connection with the relatively high proportions of private funds in these countries. The highest share with 66% of EU funds is seen in Estonia. The explanation for such decisions in Candidate Countries between EU funds and national/private funds should be sought in a combination of several factors. One could be a country's *GDP per capita*, where wealthier countries count more on their own budgets and private sector involvements. We should add this is also an important factor for the European Commission when negotiating relative shares of EU co-financing. Another could be the relative level of *commitment appropriations in per capita terms*; in our sample of countries we could say that higher per capita allocations of EU funds go together with a higher share of EU allocations compared with national funds. From this point of view, the situation in Slovenia and Hungary is similar to the situation in EU Non-Cohesion Countries as described in the first part of this paper.

We must be aware that different financial allocations between funds and sectors are only one indicator of the absorption capacity for Structural Funds, while a comparison with the situation in Member States can also be valuable. However, to make forecasts of the absorption capacity after 2004 what is decisive is the administrative capacity and capability to spend these funds already before accession, namely in the period before May 2004.

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Annexes

Annex 1: GDP price index in Objective 1 Member States

1994 = 1

Portugal	1.183
Spain	1.169
Ireland	1.212
Greece	1.365
UK	1.15
Germany	1.054
France	1.06
NL	1.087
Italy	1.181
Belgium	1.069
Austria	1.06

Source: OECD, National Accounts Statistics

Annex 2: Expenditures and absorption rates in CCs and Non-CCs

Table A1: Share of Planned and Actual Expenditure in Objective 1 Cohesion Countries in 1994-99 - ALL FUNDS

in %

<i>Expenditure</i>		ERDF	ESF	FIFG	EAGGF	Other Public	Private	Total
Portugal	<i>Planned</i>	32.7	11.8	0.8	7.1	22.7	24.9	100
	<i>Actual</i>	36.1	13.2	0.0	7.4	25.1	18.1	100
Spain	<i>Planned</i>	32.6	12.4	2.0	6.8	26.1	20.1	100
	<i>Actual</i>	40.2	15.7	2.5	7.9	33.7	n/a	100
Ireland	<i>Planned</i>	24.6	19.0	0.5	10.3	21.9	23.7	100
	<i>Actual</i>	25.5	19.9	0.5	10.6	24.0	19.5	100
Greece	<i>Planned</i>	35.1	9.8	0.5	7.7	25.7	21.1	100
	<i>Actual</i>	40.4	10.4	0.5	6.9	27.2	14.6	100

Table A2: Financial Absorption in Objective 1 Cohesion Countries in 1994-99; ALL FUNDS
in MEUR, Prices 1994

<i>Expenditure</i>		Total	ERDF	ESF	FIFG	EAGGF	Other Public	Private
Portugal	<i>Planned</i>	26,678	8,723	3,148	213	1,894	6,056	6,641
	<i>Actual</i>	20,617	7,451	2,726	8	1,519	5,178	3,735
	Absorption (%)	77.3	85.4	86.6	4.0	80.2	85.5	56.2
Spain	<i>Planned</i>	48,903	15,944	6,047	995	3,314	12,751	9,853
	<i>Actual</i>	34,340	13,801	5,388	861	2,712	11,580	n/a
	Absorption (%)	70.2	86.6	89.1	86.5	81.8	90.8	n/a
Ireland	<i>Planned</i>	10,253	2,523	1,953	47	1,058	2,244	2,428
	<i>Actual</i>	8,450	2,151	1,686	40	896	2,031	1,646
	Absorption (%)	82.4	85.3	86.3	84.3	84.7	90.5	67.8
Greece	<i>Planned</i>	28,210	9,907	2,773	142	2,184	7,250	5,953
	<i>Actual</i>	20,312	8,201	2,115	100	1,404	5,530	2,961
	Absorption (%)	72.0	82.8	76.3	70.7	64.3	76.3	49.7

Table A3: Share of Planned and Actual Expenditure in Objective 1 Non-Cohesion Countries in 1994-99; ALL FUNDS
in %

<i>Expenditure</i>		ERDF	ESF	FIFG	EAGGF	Other Public	Private	Total
UK	<i>Planned</i>	23.5	13.2	0.6	4.3	30.6	27.8	100
	<i>Actual</i>	20.7	16.7	0.7	4.9	27.1	12.3	82
Germany	<i>Planned</i>	11.8	7.1	0.1	4.6	17.7	58.7	100
	<i>Actual</i>	15.1	9.1	0.1	5.8	10.6	44.3	85
France	<i>Planned</i>	23.8	10.5	0.8	8.6	38.8	17.5	100
	<i>Actual</i>	19.4	12.0	0.3	7.7	30.8	13.0	83
NL	<i>Planned</i>	10.0	5.0	2.6	1.3	51.1	30.2	100
	<i>Actual</i>	9.5	3.4	2.4	1.5	52.9	30.2	100
Italy	<i>Planned</i>	29.8	8.4	0.7	6.9	31.8	22.4	100
	<i>Actual</i>	31.1	7.0	0.7	6.3	68.9	n/a	114
Belgium	<i>Planned</i>	21.4	6.9	0.0	1.9	31.0	38.8	100
	<i>Actual</i>	18.3	6.7	0.0	1.8	28.7	44.4	100
Austria	<i>Planned</i>	12.9	4.0	0.0	3.0	34.1	45.9	100
	<i>Actual</i>	11.1	3.4	0.0	2.5	26.7	63.6	107

Table A4: Financial Absorption in Objective 1 Non-Cohesion Countries in 1994-99; ALL FUNDS
in MEUR, Prices 1994

	<i>Expenditure</i>	Total	ERDF	ESF	FIFG	EAGGF	Other Public	Private
UK	<i>Planned</i>	5,671	1,332	747	35	246	1,733	1,578
	<i>Actual</i>	4,177 (3,445)	864	698	30	205	1,132	516
	Absorption (%)	73.7 (60.8)	64.9	93.5	84.5	83.4	65.3	32.7
Germany	<i>Planned</i>	63,100	7,432	4,459	91	2,882	11,176	37,061
	<i>Actual</i>	45,771 (38,913)	6,895	4,161	68	2,671	4,847	20,270
	Absorption (%)	72.5 (61.7)	92.8	93.3	75.1	92.7	43.4	54.7
France	<i>Planned</i>	5005	1,193	525	40	431	1,941	874
	<i>Actual</i>	3,792 (3,150)	735	454	11	292	1,166	492
	Absorption (%)	75.8 (62.9)	61.6	86.4	28.3	67.6	60.1	56.3
NL	<i>Planned</i>	844	84	42	22	11	431	255
	<i>Actual</i>	686	65	23	17	10	363	207
	Absorption (%)	81.3	77.8	54.8	75.3	92.0	84.3	81.2
Italy	<i>Planned</i>	32,439	9,660	2,739	233	2,228	10,327	7,252
	<i>Actual</i>	25,865 (29,470)	8,057	1,799	175	1,630	17,809	n/a
	Absorption (%)	79.7 (90.8)	83.4	65.7	75.2	73.2	172.4	n/a
Belgium	<i>Planned</i>	2,412	516	167	0.37	47	747	935
	<i>Actual</i>	1,899	348	128	0.36	35	545	843
	Absorption (%)	78.7	67.4	76.7	98.6	73.6	73.0	90.1
Austria	<i>Planned</i>	906	117	36	0	27	309	416
	<i>Actual</i>	981 (1,052)	108	33	0	25	262	624
	Absorption (%)	108.3 (116.2)	92.7	91.7	0	90.8	84.9	149.9

Annex 3: Notes on the country-related data

Portugal: Under the actual expenditure the data are executed according to the OP's Final Executions Reports of DGDR data.

Ireland: Actual expenditure covers the period 1994-2001 and does not include expenditure under the Hospital Infrastructure OP which accounted for 1.5% of total planned ERDF expenditure and 3.8% of total planned national expenditure. The figure of total actual expenditure excludes expenditure of MEUR 27 under the European Fund for Technical Assistance for the Human Resource Development OP.

UK: Sum of totals are for Merseyside, Northern Ireland and Highlands and Islands. In the case of actual expenditure for Highlands and Islands, national public and private expenditure details have not been available to date from the Scottish Executive.

Germany: Under actual expenditure is expenditure committed by 31.12.1999 according to the CSF Report of Activities in 1999.

France: Under actual expenditures payments are calculated without Guyane.

NL: Sources for both planned and actual expenditure are provisional financial tables of the PME Province Flevoland.

Italy: The actual expenditure data are as at 31.12.2001, but are not the final data. The Treasury gave expenditure data only for total costs. For this reason, the figure for Structural Funds and total national funds were estimated (assuming that the ratio between SF and national funds has not varied), but it was not possible to estimate data for public and private national resources.

Austria: Under actual expenditure these is public expenditure committed by 31.12.1999 and related private expenditure, rounding off differences is possible.

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