The Impact of EU Funds on Romanian Finances

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The views expressed herein are those of the author. I would like to thank Ella Kallai and Valentin Lazea for their useful comments on an earlier draft of the paper. All remaining errors are the author's alone.

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List of Abbreviations Used in the Text

CAP	Common Agricultural Policy
CF	Cohesion Funds
EAGF	European Agricultural Guarantee Fund
EAFRD	European Agricultural Fund for Rural Development
EFF	European Fund for Fisheries
EC	European Commission
EU	European Union
GNI	Gross National Income
MEA	Ministry of European Affairs
MFF	Multiannual Financial Framework
NDP	National Development Plan
NMS	New Member States
TOR	Traditional own resources
VAT	Value Added Tax

1. Introduction

The results of the current on-going negotiations over the EU's 2014-2020 budget are bound to be shaped to a great extent by the existing fiscal constraints of the EU member states. The negotiating position of Romanian authorities favours an increase in the size of the EU budget. This stance is not surprising given that Romania is a net beneficiary of EU funds. But, it may look contradictory in the light of the country's poor track record of EU funds absorption. At the end of March 2012, after more than five years into the current fiscal exercise, Romania's certified absorption rate, including pre-financing, stood at 17.8%[1] compared to an EU-average of above 33%. Excluding pre-financing the absorption rate was much lower, at 6.6%.

Systematic irregularities in the public acquisitions processes have led to a suspension of payments from the Regional Operational Programme. At the time of writing, the Human Resource Development Operational Programme has been interrupted by the EC on concerns about costs misallocation. The Romanian authorities are bound to miss their 2012 EU funds absorption target rate of EUR 6 Bn. by quite a margin and there is an increasing high probability that some funds allocated in the current fiscal exercise will be lost. This has recently prompted the Romanian authorities to ask the EC for an extension of the *'n+2'* rule.

There is another aspect which is being consistently overlooked by the authorities in their bid to support a higher EU budget, namely the direct effects that higher EU contributions and committed funds to project co-financing have on the domestic budget deficit. The conditions laid out in the Fiscal Pact, to which Romania is a signatory, set a ceiling for the structural budget deficit at -0.5% of GDP. Given the current structure of government expenditure this target would be extremely difficult to meet on a *consistent* basis in the future. Any increase in the EU budget would place additional (and unnecessary, in the light of the existing low absorption rate) pressures on Romania's budget deficits over the next EU fiscal exercise.

Obviously, higher effective absorption rate alone, even if achieved eventually, it is not sufficient to ensure higher economic growth. The key questions are if EU funds are used for the appropriate projects and if they are successful in meeting the objectives for which they have been conceived. It is well acknowledged the fact that Romania's strategic objectives, laid out in the National Development Plan 2007-2013, failed to match the objectives set in the Operational Programmes. This resulted in a funds allocation mismatch which led to negotiations between Romania and the EC for a EU funds reallocation among operational programmes.

The primary aim of this paper is to look at the potential consequences an increase in the EU budget would have onto the size of the domestic budget deficits. As the simulations in this paper show, if the EU budget for the 2014-2020 period was adopted in the current form put forward by the EC, the resulting increase in Romania's annual budget deficits would average somewhere between 0.1-0.2% of GDP during the next fiscal exercise.

[1] This refers to the structural funds alone.

Another issue addressed is the impact of the EU funds on Romanian GDP and employment. After more than five years this impact appears to be modest and below initial expectations. Part of the reason the full potential of EU funds has remained unfulfilled for so long relates to issues of domestic governance. Sorting out this problem should constitute a priority for the Romanian authorities. Thus, maximising the impact of the EU funds by markedly improving the administrative capacity to control projects and ensuring efficient project allocation and implementation should get pre-eminence. It makes little sense to advocate an increase in the size of the EU budget if there was a high probability that domestic constraints to funds absorption would lead, anyway, to a disengagement of future EU funds[2].

The paper is structured as follows. Section 2 provides an overview of the current state of EU funds absorption and lists some of the main causes which hindered the absorption process. Section 3 highlights the proposed changes to the next MFF and describes briefly the proposed changes in the management of the EU Funding. Section 4 addresses the fiscal implications of the EU Funds on Romania's budget over the 2014-2020 period. It quantifies the direct costs to the Romania's budget and assesses the implications for the budget deficit under different scenarios by varying the size of the EU budget, Romanian GDP growth and co-financing rates. Section 5 looks at the impact of the EU funds on Romania's economic growth and employment. The final section concludes and puts forward several policy implications.

2. Romania's EU Funds Absorption in the Current Fiscal Exercise

This section provides a brief overview on Romania's net financial position with the EU and the current state of implementation of EU Funds by Romania. Over the 2007-2013 period Romania was allocated EUR 19.67 Bn in structural and cohesion funds and, after more than five years, Romania's payment ratio[3] is one of the lowest among the 10 Central and Eastern European (CEE) countries while the contracting ratio stands below CEE average.

Regarding the latter however, there is a large asymmetry among different operational programmes. According to the data from the Ministry of European Affairs, at the end of March 2012 the contracting ratio for 'Human Resource Development' programme stood at 84% while that for the 'Transport' sector was only 40%.

Although Romania is a net beneficiary of EU funds, the current absorption rate of the EU funds is low[4]. Section 2.3 below lists some of the determinants which have impeded the realisation of a higher absorption rate. To avoid losing EU funds, Romania would need to absorb around EUR 16.5 Bn. for the Cohesion Policy and EUR 5.7 Bn for the Pillar 2 of CAP by the end of 2015, when disbursements to the current financial exercise end.

[2] There is also a broader question often asked in empirical analyses, namely to what extent the EU funds have helped achieving their stated objective of fostering economic growth and promoting convergence. This aspect is not addressed here.

[3] The ratio between the amount actually paid by the EC and the total allocated for the current fiscal exercise.

[4] For comparison of the state of EU funds absorption across 10 CEE countries see for instance KPMG (2010)

2.1 Romania's Net Payment Balance with the EU

The EU budget is financed through three main categories of resources: traditional own resources, the VAT-based resource and the GNI-based resource[5].

- Traditional own resources (TOR) comprise customs and agricultural duties and sugar levies. The Romanian authorities retain 25 % of the amounts collected, to cover collection costs.
- The VAT-based resource is calculated based on a call rate to Romania's VAT base. The 'revenue method' is used to obtain a so-called harmonised VAT base[6].
- The GNI-based resource is a 'residual' resource because is determined so that total EU revenue balances total expenditure. The GNI-based resource has gradually become the most important source of financing of the EU budget, representing on average 60 % of total own resources.

Table 2.1 below details Romania's contributions to the EU budget for the 2007-2013 financial exercise. Actual data is used for the 2007-2011 period and forecasts for 2012-13.

Table 2.1 Romania's Contributions to the EU Budget, 2007-2013, Mill EUR, current prices

	2007	2008	2009	2010	2011	2012*	2013*
VAT-based own resource	162.1	168.5	156.6	124.1	145.3	148.6	149.6
GNI-based own resource	681.7	741.1	901.8	859.2	965.1	974.1	1,005.1
Corrections[(a)]	86.5	108.1	159.6	58.9	59.9	62.5	64.1
Total national contribution	930.3	1,017.7	1,218	1,042.2	1,170.3	1,185.2	1,218.8
Traditional own resources (TOR) (75%)	159.2	199.9	124.3	100.9	121	138.6	138.9
Total own resources, EUR Mill	1,089.4	1,217.6	1,342.3	1,143.1	1,291.3	1,323.8	1,357.7
Total own resources, as % of GDP	0.87	0.87	1.13	0.92	0.95	0.94	0.90
GDP	124,703	139,710	118,334	124,175	136,510	141,567	150,603
Avg. Exch.R RON/EUR	3.34	3.68	4.24	4.21	4.24	4.32	4.29

* - forecast, author's calculations and data from the Budget Report 2011.
a – includes the UK correction, the adjustment re-implementation of the 2007 Own Resources Decision, restitution to lump-sum for Netherlands and Sweden and the JHA adjustment for Denmark, Ireland and the UK.

[5] These are supplemented by various correction mechanisms. For more details on how each revenue item is calculated see European Commission (2008).
[6] Technically this is done in two steps. First, an intermediate VAT rate is obtained by dividing the total annual VAT revenue collected by the Romanian government by the weighted average rate of VAT. Second, the intermediate base is subsequently adjusted, either with negative or positive compensations, to obtain the harmonised VAT.

Romania's total contributions to the EU budget for the period 2007-2013 should average a little over EUR 1.2 Bn. annually, representing on average, the equivalent of approximately 0.95% of GDP. The nominal amount of VAT resource paid would depend, indirectly, on economic growth, and the level of domestic VAT.

Romania's payments from the EU together with the net balance data are presented in Table 2.2 below. Forecasts for Structural and Cohesion Funds for the years 2012 and 2013 assume a significant increase in the nominal amounts, compared to previous years. This would only be possible if the existing systematic irregularities found by the EC in a series of public acquisitions processes were swiftly addressed. In nominal terms, net payments had been on a rising trend until 2009. Sums received from the EU were marginally higher in 2011 but, given the *'n+2'* rule, representing the years by which funds must be spent, the amounts absorbed should have been much higher[7]. The EU payments of structural and cohesion funds in both 2010 and 2011 was a little over EUR 550 Mill., lower than in the two preceding years. Direct payments to farmers (Pillar 1 of CAP) are expected to increase over the 2011-2013 period when compared to the previous three years.

Table 2.2 Romania's Payments from the EU and the Net Balance, Mill EUR, current prices

		2007	2008	2009	2010	2011[e]	2012*	2013*
Pre-accession funds		789.1	744.8	618.9	277.8	201.7	0	0
Structural and Cohesion Funds		451	684.8	965.2	566.8	579.7	1,669.3	2,948.9
CAP Payments, *of which*:		6.9	1,620.7	2,098.9	2087	2,749.0	2,812.0	2,628.0
	EAGF[(a)]	6.9	474	596.2	670.8	1,720.0	1,605.0	1,241.0
	EAFRD and EFF[(b)]		1,146.7	1,502.7	1,401.6	771.8	905.3	1,040.3
Total EU payments		1,602.4	2,666.2	2,951.2	2,317.4	3,273.2	4,179.5	5,230.1
Net EU Payments[(d)]	Mill EUR	513.0	1,448.6	1,608.9	1,174.3	1,981.9	2,855.7	3,872.5
	% of GDP	0.4	1.0	1.4	0.9	1.5	2.0	2.6

* - forecast, author's calculations and data from the Budget Report 2011;. e – estimated.
a – European Agricultural Guarantee Fund (EAGF)
b – European Agricultural Fund for Rural Development (EAFRD) and European Fund for Fisheries (EFF)
d – Obtained by subtracting total own resources (Table 2.1) from total payments from the EU.

[7] It is well acknowledged that programmes rarely start in full flow at the beginning of the year they were budgeted. In general, programmes' expenditure in the early months tends to be slow and this generates more pressure on programmes to perform in subsequent years, in order to avoid the loss of funds through the n+2 rule.

As a percentage of GDP, net EU payments for the period 2007-2011 represented a cumulative of a little over 5% of GDP, an average around 1% of GDP per year. Even if net EU payments rose to the equivalent of 2.3% of GDP over the next two years, as forecast in Table 2.2, the total amount absorbed would still fall short of the equivalent of 17% of GDP, which represents an estimate of the overall pre-allocation funds[8].

2.2 The Current EU Funds Absorption Rate by Operational Programmes

All EU funds are pre-allocated to each EU member country according to the recipient's level of economic development, population size and surface area, and subject to agreement on so-called Operational Programmes. Table 2.3 below presents the situation of EU Funds absorption rate by individual Operational Programmes at the end of March 2012. It can be noticed that there exists a visible asymmetry among the operational programmes with certified absorption rates varying between 3.4% for the SOP Environment and 11.7% for the OP Regional.

Table 2.3 Romania's EU Absorption Rate, end March 2012.

	Total Allocation, 2007-2013, EUR Bn.	Absorption rate (including pre-financing), % of total allocation	Cumulative attracted funds (including pre-financing), EUR Bn.	Certified absorption rate, % of total allocation
OP Regional	3.8	27.8	1.04	11.7
OP Technical Assistance	0.2	14.4	0.02	9.8
OP Enhancing Administrative Capacity	0.2	13.4	0.03	9.1
SOP Enhancing Competitiveness	2.7	17	0.43	6.4
SOP Transport	4.6	7	0.32	6.1
SOP Human Resources Development	3.7	28.9	1.00	5.5
SOP Environment	4.5	12.7	0.57	3.4
Total	***19.7***	***17.8***	3.42	***6.6***

Source: Ministry of Romanian Affairs

A report by the Romanian Academic Society (2012) analyses the factors that hinder the absorption of EU funds in Romania by looking at the most successful programme so far, OP Regional. One of the conclusions is that, although there are number of projects that are being currently implemented, project completion is relatively weak. This can be seen from Table 2.3 when comparing the absorption rate that includes pre-financing (column 2) with the certified absorption rate (column 4). Also, when it comes to project contracting, there are marked differences among various regions.

[8] For a complete evaluation of EU funds absorption over the 20107-2013 period Table 2.2 should have included years 2014 and 2015, as required by the 'n+2' rule.

At the end of 2011 Romania had the weakest cohesion funds absorption performance among EU countries with an absorption rate of just 16.5% compared to an average EU rate of 33.4%[9].

2.3 Obstacles to the EU Funds Absorption Process

Although the absorption of EU funds has improved gradually over the last year, the certified absorption rate by the EC continues to remain weak. In September 2011 the Romanian Parliament approved the creation of the Ministry of European Affairs (MEA), with the aim of accelerating the absorption of EU funds. This decision highlighted the dire state of affairs in the EU funds absorption process and the urgent necessity to address the existing flaws, which hampered the increase in Romania's effective absorption rate[10]. However, the existing structural deficiencies in the institutional architecture of EU management funds rendered MEA's role to one in which it exerted an influence focused more on control and coordination. A measure which could have had a positive impact on the absorption rate was the centralisation of activities from the existing seven management authorities. The main obstacle in achieving this objective however, was the requirement to obtain new accreditation from the EU for the newly set-up authorities. Such an option was not feasible due to the length of time required to obtain new EU accreditation[11]. Nevertheless this option should be seriously considered as a structural measure to improve EU funds absorption during the EU's next financial exercise 2014-2020.

The causes of a weak utilisation of EU funds are various and Romania is, on almost all accounts, a relatively poor performer having difficulties at all levels of programme implementation, starting with the evaluation and selection of the projects. There are a number of papers which identify the causes of the weak EU absorption. (see for instance Socol et. all 2009, Georgescu G. 2009 or Zaman G. and Cristea A. 2011) The lack of administrative capacity has also been one of the main reasons for the poor EU funds absorption[12]. Among the most relevant causes for the observed dismal rate of EU funds disbursement are:

Poor strategic planning and uncorrelated objectives. One reason for the low absorption funds rate has been the initial poor planning and setting of strategic objectives in the National Development Plan 2007-2013. These failed to meet, in a satisfactory manner, the objectives laid down in the Operational Programmes. This resulted in a funds allocation mismatch, which the authorities have recently addressed by negotiating with the EC a reallocation of EU

[9] http://ec.europa.eu/regional_policy/newsroom/detail.cfm?id=165 (accessed at 29 April 2012). Including claims pending at the end of 2011 and aimed at being paid on 2012 credits.

[10] The Ministry of Romanian Affairs was set up at a time when payments from the Regional Operational Programme were suspended by the EC due to systematic irregularities found in the public acquisitions processes. Subsequently, the financing of Human Resource Development Operational Programme was interrupted by the EC on concerns about costs misallocation.

[11] SOP Transport, for instance, was accredited in August 2009, more than two years and a half after Romania's EU accession.

[12] Romania has a specially designed Operational Programme, designed to improve administrative capacity, with an EU allocation of EUR 0.2 billion where the absorption is somewhat better.

funds between operational programmes[13]. Such actions would support the finance of additional needs that occurred and were not envisaged for financing within the current 2007-2013 programming period.

Insufficient administrative capacity. The local authorities' capacity to implement EU project varies greatly across regions and operational programmes[14]. There were long delays in the setting-up of inter-community development associations, an institutional prerequisite at the project application stage, for water/waste management projects. In many cases local authorities failed to provide timely guidelines and the necessary supporting methodology to the applicants.

Limited expertise capacity at central and local administration. There is a lack of qualified personnel, especially at the local level of public authorities. This issue is compounded by the poor quality of strategic planning and designing and enforcement of multi-annual budgets.

Limited accountability of public procurement agencies in the tendering process. The responsibility of state structures dealing with public acquisitions in the EU funds managing mechanism was notoriously absent. This led to a string of contested tenders and long delays in project implementation. An inquiry by the EC has found that errors in the public acquisitions mechanism were systematic. Recently, authorities' efforts have focused on improving monitoring and increased accountability of public procurement agencies in the tendering process while also developing standard bidding documents.

The lack of project experience of both management authorities and beneficiaries. There are noticeable differences among state institutions which managed funds prior to Romania's EU accession and those which have not. Beneficiaries have often run into difficulties at the project preparation and implementation stages due to procedural complications. Moreover, modifications in the national legislation often were not reflected in the applicants' guides. This generated a significant delay in the launch of project applications.

Financing constraints. The on-going economic crisis and the need for bank restructuring made access to credit for co-financing EU projects more difficult. In addition, the applicants are reluctant to commit own funds to co-finance projects even though the individual financing shares are small. Such reluctance to shoulder any risk by the applicants could render bank financing more difficult.

Long periods of time for project evaluation, selection and contracting processes. The timeframe used to be up to ten months from the submission until notification of the results. Payment disbursements to beneficiaries were also taking more than 60 days. A recent Government Ordinance shortened this period of time to a maximum of 45 days.

Project evaluation and prioritisation. The limited absorption rate and administrative resources put a strain on the effectiveness of project implementation. Recently, the authorities

[13] Envisaged financing resources failed to cover adequately important areas, such as transport infrastructure of both national and European interest.
[14] For instance, at the beginning of 2012 in the Water Management there were 38 priority projects. In 10 of these cases the implementation level varied among 37-70% while in remaining cases it stood at between 0- 5%.

set up a database of all government projects and approved a list of EU-funded priority projects. Evaluation procedures would select those projects where funding can be fully secured within a medium-term horizon.

A relatively poor level of qualification from the part of the consultants involved in preparing projects. Often, the projects fail to get financing due to the fact that they are poorly prepared. The consultants employed to write these projects are often

Funds misallocation and procedural irregularities. The investigations into the use of EU funds by the Romanian authorities, undertaken by the EU representatives in 2012, have revealed procedural irregularities in a number of projects under various operational programmes. The suspension and/or interruption of some of the operational programmes have hampered significantly the absorption of EU funds, especially throughout 2012. This situation, however, is likely to continue even in 2013. Moreover, the audit procedures have exposed flaws in spending EU funds with part of the funds being improperly spent. As a consequence, Romania will have to pay back a share of the EU funds it received. This is likely to create additional financial problems for both Romanian authorities and the recipients of EU funds.

Addressing the issues that constrain the pace of EU funds adoption is paramount not only for the current EU fiscal exercise, where the risk of funds being lost increases, but also for the 2014-2020 programming exercise, in which the management of the EU funds would need to be much better managed.

3. The 2014-2020 EU's Multiannual Financial Framework (MFF)

3.1 Proposed Changes to the next MFF

In June 2011 (EC, 2011b) the EC laid out its budget proposal for the next financial framework. But, current discussions among the EU member countries go beyond the debate on the size of the 2014-2020 budget and attempt to address also the design of the EU's financial framework as well as the objectives and management of the EU funds for the period 2014-2020.

The financing structure of the EU budget has been repeatedly called into question over the recent years. In the current 2007-2013 MFF more than 85% of EU financing is based on national contributions derived from gross national income and VAT. Both these sources are widely perceived to be minimised by individual member states. To this end the EC has proposed a gradual change in the EU's financing structure, aiming to increase the size of its new own resources. Under the existing plans, these new own resources would account for an increasing share of financing the EU budget and are expected to replace, eventually, the current VAT-based own resource while reducing the scale of the GNI-based resource.

Although this approach is intended to diminish the amount of direct contributions from member state budgets it would inevitably mean the introduction of new financial mechanisms which could collect revenues at the EU level[15]. A report prepared for the European Parliament (EP 2006a) lists several options for potential revenues to be raised at the EU level. For instance, these could come from the taxation of the financial sector, auctioning under the greenhouse gas Emissions Trading System, charges related to air transport, VAT, energy tax or corporate income tax, all applied at the EU-level. The EC argues that the purpose of identifying new own resources is ‘not to increase the overall EU budget but to move away from the "my money back" attitude and to introduce more transparency into the system’. It remains to be seen which of these financing means will be eventually adopted. Nevertheless, the prevailing view among EU countries is that there is an increasing need to modernise EU finances by simplifying Member States' contributions, introducing new own resources and gradually phasing-out all correction mechanisms.

3.2 Changes in the Management of the EU Funding

Beyond the envisaged changes in the financing structure of the EU budget, the management of EU funding is also due to change from 2014 onwards. Thus, prior to the new financial exercise, in 2013, each Member State would need to prepare a Partnership Contract (PC) with the EC. The role of the PC would be to assess national development needs and define priorities for the use of EU funds so that the latter could be used more efficient in meeting the Europe 2020 targets. Thus, each Member State would need to commit itself to a set of investment priority plans which would need to be in line with its economic growth objectives. The EC remains committed to continue supporting less developed regions, which will remain an important priority for cohesion policy. Given the fact that all Romanian regions, except Bucharest, record GDP per capita which is less than 75 % of the average GDP of the EU-27, Romania will continue to qualify for EU cohesion funds (see Annex 1).

For the 2014-2020 fiscal framework the management of EU funds would fall under two categories[16]. The first category would see the EU funds management shared between the EU and the Member States. Structural and Cohesion Funds as well as the EMFF and the EAFRD would fall under this category. These would account for a large share of the EU budget, more than three quarters of the budget being allocated to shared funds. In contrast, the EU funding of research activities, environment and external action funds would fall under the second category, in which the funds management would be controlled at the central level, by the EC.

Agricultural expenditure will continue to be financed by two funds, namely the European Agricultural Guarantee Fund (EAGF), or pillar I of the Common Agriculture Policy (CAP) and the European Agricultural Fund for Rural Development (EAFRD), or pillar II of the CAP. The former is expected to have allocated around €317.2 and to finance direct payments

[15] The EC (EC 2011b) lists a series of criteria such mechanisms would need to meet. Thus, they should be based on a system covering the whole internal market, have a harmonised base and the proceeds of any potential new resource should be collected directly by the EU, outside national budgets. Such changes would inevitably lead to an increased level of fiscal centralisation at the EU-level, an outcome which, at the moment, is not supported by all EU member states.

[16] EC2011b

to farmers and measures to regulate agricultural markets such as intervention and export refunds while the later would be around a third less and would finance rural development programmes of the individual EU members. But, the CAP reform proposals[17], envisage a new design of direct payments in order to enhance synergies with Pillar II. The latter would be placed under a Common Strategic Framework in order to achieve a better coordination with other EU shared management funds.

3.3 Negotiating Positions of the EU Members

At the end of June 2011 the European Commission presented its budget proposal for the 2014-2020 period in its report ‘A budget for Europe 2020’. The EU member countries are split into two groups over the size of the budget. One group, comprised by Austria, Czech Republic, Finland, Germany, Netherlands, Sweden and United Kingdom are in favour of a decrease in the proposed overall amount for the EU budget. The other group of countries, made of by Belgium, Bulgaria, Croatia, Cyprus, Estonia, Hungary, Lithuania, Poland, Romania and Slovakia support the EC’s proposed overall amount. The majority of those arguing for a reduction are net contributors of the EU budget while the majority of those arguing for the proposals are net recipients.

Cohesion Policy, which represents 36.7% of the EU budget under the current EC proposal, would most likely suffer if the overall budget was reduced. Among countries which stated that Cohesion Policy is among their priorities are Croatia, Czech Republic, Estonia, Lithuania, Romania and Slovenia[18]. Those looking to keep the Cohesion policy at the same level as proposed by the EC are likely to argue for the cuts to be made elsewhere. Romania, along with Lithuania and Slovenia also declared CAP as their priority. The EU objective is to reach an agreement by the end of 2012 on the overall MFF framework to ensure a timely implementation of the 2014 annual budget.

4. Implications of the EU Funds for Romania’s Budget over the 2014-2020 Period

4.1 Introduction

The economic implications of EU transfers are significant. An EU-member country could attract EU-related inflows equivalent to up to 4% of its GDP. This is a large amount which could have profound macroeconomic repercussions. However, assessing the exact effects on the economy is notoriously difficult. Usually first round effects are followed by subsequent rounds effects which would impact domestic demand to different degrees, through various channels, depending on the initial source of funding, the actual amounts disbursed and funds’ destination. Timing issues could further complicate the economic assessment results as the effective release of EU funds occurs with a time lag, after the required documentation is

[17] A detailed explanation of the reform proposals are in European Commission (2011c) and European Parliament (2011)

[18] See Annex 1 for a map of countries which would benefit the most from the Cohesion Policy programmes.

approved by the EC. The existence of time lags in impact evaluation exercises implies that EU funds could end up reflecting past economic activity.

Overall however, the EU transfers are expected to represent a significant injection of capital into the Romanian economy so that the medium and long term fiscal effects of the EU financial flows should be marginally favourable. A controversial issue is whether EU funds crowd out or augment domestic public spending. Although the EC imposes the principle of additionality, which implies that the EU funds should not replace the national or equivalent expenditure by a Member State, in practice this is difficult to verify. This additionality principle is extremely relevant as the economy's dependence on EU funding could raise competitiveness issues once the EU funds are phased out.

The fiscal implications of EU funds are rather complex. On estimating the budgetary effects of EU funds, several issues need to be borne in mind:

The distinction between projected and committed flow of funds. This will affect how these funds are recorded in centralised government balances due to existing differences in the accounting rules[19]. Three year ahead forecasts of government expenditure on EU-related costs are presented in Romania's Convergence Programmes but the ex-post assessments of these show discrepancies between the amounts budgeted and those which were subsequently spent.

Co-financing. The EU requirement of EU projects co-financing from national sources raises the issue of who is the final beneficiary of the funds in practice. Usually, agricultural funds are directed towards the private sector while cohesion funds are directed to the public sector. Regarding the latter however, the end-user private – public distinction is rather difficult to make in practice.

Estimating the net budgetary effect of EU funds. The initial direct effect on government finances is negative as there are costs associated with the national contributions towards the EU budget (although there are offsetting elements), domestic public expenditure to co-finance EU funds as well as advance EU payments to farmers and insufficient absorption capacity of the allocated EU transfers. Subsequently, there might be a marginal positive effect on government revenues via the expected increase in tax revenues generated by higher future output if the EU funds were efficiently used. But such effects could only be evaluated on a longer time period.

One can argue that part of the EU budget transactions could be treated as direct payments between the rest of the world and domestic residents without affecting national budgets. On the revenue side the direct agricultural subsidies fall into the direct payments category. In contrast, on the expenditure side there are the traditional own resources such as import duties and agricultural levies and the VAT resource. On average these flows cancel each other out.

[19] The cash-based rule, used in practice by most national governments, including Romania, and the accrual based ESA95 rule, used by the EC. The later is employed to examine compliance with EU deficit limits.

This line of argument would stand if the EC's principle of additionality were to be respected in full. In practice, however this is rather difficult to verify.

4.2 Direct Costs to the Romania's Budget for the 2014-2020 Period

This section estimates the direct costs to the Romanian budget of EU funds - related expenditure for the 2014-2020 period. There are two main sources of public expenditure which are considered in the current analysis: Romania's contribution to the EU budget and public sector's co-financing contribution to the EU projects. Inherently, there is a significant amount of uncertainty regarding the estimation of these expenditure flows. This uncertainty relates to both the pace of Romania's economic growth and its absorption rate.

The forecasting process is further complicated by the fact that, at the time of writing, the overall 2014-2020 EU budget figure has not yet been agreed by member states. In order to mitigate this shortcoming the analysis takes into consideration two main scenarios, one in which there is a freeze[20] in the EU budget and a second scenario which assumes the current's EU proposal on the budget (European Commission 2011b)[21]. In order to have a broader picture of the outcome distribution of budgetary costs, uncertainties pertaining to both the pace of Romania's economic growth and project co-financing rates have also been considered.

It thus results eight scenarios which are summarised in Table 4.1 below:

Table 4.1 Overview of the Scenario Assumptions

	Freeze in the EU Budget	Increase in the EU Budget	High GDP Growth	Low GDP Growth	Maximum EU co-financing rates	Increased EU co-financing rates
Scenario 1	x			x	x	
Scenario 2	x			x		x
Scenario 3	x		x		x	
Scenario 4	x		x			x
Scenario 5		x		x	x	
Scenario 6		x		x		x
Scenario 7		x	x		x	
Scenario 8		x	x			x

Source: Author's Selection

For instance, under Scenario 1 the 2014-2020 EU budget is frozen, Romanian GDP growth is low and average co-financing rate for cohesion funds is set to 85%, the maximum allowed at this moment.

[20] A budget freeze implies that the 2014-2020 EU budget remains **unchanged in nominal terms** when compared to the 2007-2013 period. Effectively, this implies a reduction of the budget in real terms.
[21] See Annex 2 for details regarding the EU's 2014-2020 budget proposal.

Estimation on budgetary implications for the 2014-2020 period requires further assumptions on a few macroeconomic variables. Details of these together with the main working assumptions used in the eight scenarios are listed below:

- **Romanian GDP Growth** is assumed to grow at an annual rate of 3% under the 'High GDP Growth' scenario and by 2% in the 'Low GDP Growth' scenario.
- **Inflation and the Exchange Rate**. The GDP deflator, used as a measure of inflation, is set at 4.5% for 2014 and 4% from there onwards. The RON/EUR nominal exchange rate is set at 4.3 for the whole 2014-2020 period[22].
- **Romania's annual contribution to the EU budget** is assumed to be the equivalent of 0.95% of GDP. Arguably, this is a simplifying assumption. However it is closer to the average estimate Romania is expected to pay over the period 2007-2013.
- **The maximum EU co-financing rate scenario** assumes an average co-financing rate of 15% for Cohesion Funds and an average co-financing rate of 30% for EAFRD related projects. However, as the majority of the latter is directed towards the private sector it is assumed that public financing is needed for only 25% of all EAFRD funds. The EU Funds absorption rate is taken to be 100% since assuming a lower rate would bias downwards the estimates of budgetary effects. In **the increased EU-financing scenario** average co-financing rate is assumed to be higher, 30% for Cohesion Funds and 45% for the EAFRD related projects.

The pattern of EU funds allocation to Romania across the 2014-2020 period is assumed to be the same as for the period 2007-2013[23]. Although revisions of domestic sector strategies financial 'needs' could see subsequent changes in EU funds' portfolio allocations, the impact of these changes on the overall EU-related budget expenditure is likely to be relatively small[24].

The summary of results assessing Romania's budgetary costs of EU-related contributions and projects co-financing is presented in Table 4.2 below. The budgetary costs for each of the eight scenarios are expressed both in EUR terms as well as in percentages of GDP. A more detailed analysis regarding the expenditure sources that make of these budgetary costs is presented in the tables of Annex 3.

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[22] The benchmark RON/EUR exchange rate chosen might seem too strong in the light of recent exchange rate developments. However, in the medium and long term the RON should appreciate against the EUR, as implied by the economic theory, bringing back the RON/EUR forecast period average to 4.3 from the current rate of 4.5. Even the IMF implicit RON/EUR forecast for 2017 is slightly below 4 (see Romania Country Report 12/73, April 2012).

[23] The computation of the annual EUR amount estimates for both Cohesion Funds and EAFRD was done in two steps. The first step involved the calculation of the corresponding annual percentages for each category spending. These were obtained by dividing the annual amount allocated to Romania by the overall EU budget amount for each expenditure category. In the second step, the process was reversed. The percentages were used to determine estimates of annual allocation funds to Romania for both Cohesion Funds and EAFRD for the 2014-2020 period, conditional on each of the two EU budget scenarios.

[24] To a certain extent large reallocations of funds among different budget headings are constrained by the requirement to fulfil the assumed 2020 targets.

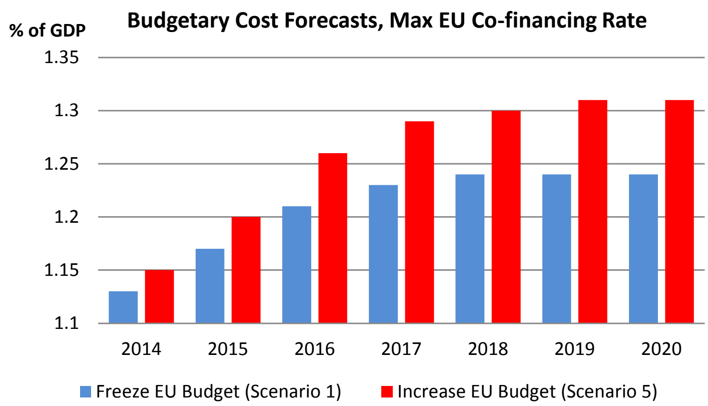
Table 4.2 Summary of Romania's Annual Budgetary Costs, EU Contributions and Projects Co-financing, Forecasts, Current Prices

		2014	2015	2016	2017	2018	2019	2020	Cum. 2014-2020*
Scenario 1	Bn. EUR	1.82	2.01	2.20	2.39	2.53	2.69	2.85	16.49
	As % of GDP	1.13	1.17	1.21	1.23	1.24	1.24	1.24	8.46
Scenario 2	Bn. EUR	2.02	2.29	2.59	2.85	3.03	3.23	3.43	19.44
	As % of GDP	1.25	1.34	1.42	1.47	1.48	1.48	1.49	9.93
Scenario 3	Bn. EUR	1.85	2.05	2.27	2.48	2.65	2.83	3.03	17.16
	As % of GDP	1.12	1.16	1.20	1.22	1.22	1.22	1.22	8.36
Scenario 4	Bn. EUR	2.05	2.34	2.66	2.94	3.15	3.37	3.61	20.12
	As % of GDP	1.24	1.33	1.40	1.45	1.45	1.45	1.45	9.77
Scenario 5	Bn. EUR	1.86	2.07	2.29	2.50	2.67	2.84	3.02	17.25
	As % of GDP	1.15	1.20	1.26	1.29	1.30	1.31	1.31	8.82
Scenario 6	Bn. EUR	2.10	2.41	2.75	3.07	3.30	3.52	3.76	20.91
	As % of GDP	1.30	1.41	1.51	1.59	1.61	1.62	1.63	10.67
Scenario 7	Bn. EUR	1.89	2.12	2.36	2.59	2.78	2.98	3.20	17.92
	As % of GDP	1.15	1.20	1.24	1.28	1.28	1.28	1.28	8.71
Scenario 8	Bn. EUR	2.13	2.46	2.82	3.16	3.41	3.67	3.94	21.59
	As % of GDP	1.29	1.39	1.49	1.56	1.57	1.58	1.58	10.46

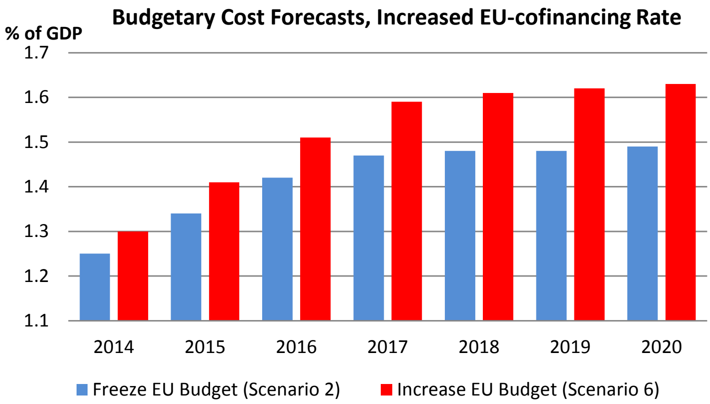
Source: Author's Calculations. * - figures are indicative only as they are expressed in current prices. The last column presents the cumulative effects.

Several remarks could be made by inspecting the figures in the table above:

- The annual direct EU-related costs to the Romanian budget vary between 1.13% and 1.63% of GDP depending on the scenario employed. Given that, on average, the equivalent of 0.95% of GDP represents Romania's EU contribution, the remaining differences account for variations in budget expenditure brought about by changes in Romania's GDP growth rates, differences in project co-financing rates and the size of the overall EU budget.
- An increase in the EU budget would automatically trigger an increase in Romania's financial commitments. These would mainly come from two sources: increased contributions towards the EU budget and higher amounts needed to co-finance EU projects. The two figures below depict projections of budgetary costs under the assumption of the EU-budget freeze/increase and Maximum/Increased EU co-financing rates. *Ceteris paribus* the increase in the EU budget, as it is implied by the current EU proposal, would raise annual domestic budgetary costs by between 0.1-0.2% of GDP.



- Annual budgetary costs could even go above 1.6% of GDP if the EU budget is passed in its current form[25], which would represent a significant budgetary effort required on a consistent basis.



- Relatively small differences in GDP growth rates would have a relatively limited impact on the budget deficit figure. However, larger variations in the forecast GDP growth rates would have a bigger impact on budgetary costs. The hypothesis of a prolonged period of lower GDP growth should not be discounted. The convergence process of the Romanian economy could run at a slower pace, when compared to the pre-2007 period, given the tensions in financial markets and higher borrowing costs.

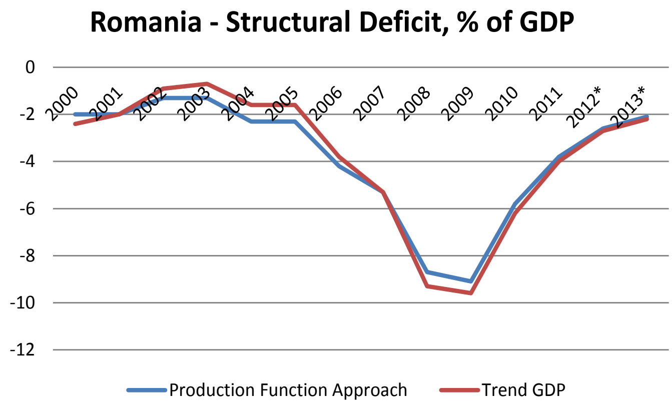
4.3 Implications for the Structural Deficit

The conditions laid down in the Fiscal Pact[26] sets stricter limits for the EU members' budget deficits[27]. The Fiscal Pact is expected to enter into force in 2013. Although Romania endorsed the Fiscal Pact, at the time of writing the Romanian Parliament has yet to decide the date from when it would abide to its rules. Given that the Fiscal Pact envisages a ceiling of

[25] As it is presented in Annex 2.
[26] The official label is " Treaty on Stability, Coordination and Governance in the Economic and Monetary Union". To be approved the Fiscal Pact requires the support of a minimum of 12 Eurozone member countries.
[27] Apart from setting limits on budget deficits, the Fiscal pact would also allow EU member states to coordinate their budget policies in a closer manner and impose penalties on rule-breakers.

0.5% for member states' structural budget deficit[28], the full compliance with the Fiscal Pact rules from 2013 onwards would put an additional pressure on Romanian public finances.

The calculation of the structural deficit is based on the estimated gap between the so-called 'potential output' (when the economy works at full capacity and inflation is non-accelerating) and the actual output. However, in practice an exact estimate of 'potential output' is rather difficult to assess[29], thus the margin of error for measuring the structural deficit is quite large. As a consequence, the fiscal policy implications of estimation errors could be quite large as the Fiscal Pact's 0.5% budget deficit ceiling would necessarily imply a far greater precision measurement in practice. The figure below shows historical data for Romania's structural deficit, expressed in percentages of GDP, as computed by the EC. Two things stand out. First, there is a discrepancy between the structural deficits figures which comes from the methodology employed. Although the differences appear to be small, the implication of these would be much larger in practice if the structural budget deficit ceiling was 0.5% of GDP.



Source: Eurostat

Second, Romania's structural budget deficit was consistently larger than 1% of GDP over the last 12 years. The structural deficit widened from 2006 onwards, partly due to higher expenditures in the economic boom years. But, payment contributions to the EU budget and public sector funds aimed at project co-financing played also a role in extending the budget deficit gap. This could lead to emergence of the so-called 'fiscal drag'. Although the EU funds could provide an opportunity to increase investment spending this will widen the budget deficit. The requirement to meet the Fiscal Pact budget deficit criteria would prevent fiscal loosening. Thus, co-financing would need to be provided through reduced spending elsewhere[30].

Bringing the structural deficit below -0.5% of GDP might be achieved sometime after 2014 but maintaining the deficit at that level on a *permanent basis*, would be utterly challenging

[28] Under certain circumstances the medium term objective of structural budget deficit could reach -1% of GDP.
[29] The estimates of potential output are usually available with a time lag.
[30] In a presentation made by the Fiscal Council (2012) it was argued that the EU funds absorption could provide an enormous stimulus for the economy and that for 'each 1 RON of own resources (budgetary deficit), public expenditure amounting 20 lei can be made'. This overlooked the implications of co-financing on budget deficit.

given the current structure of government spending. Future financial commitments to social security as well as the required financial outlays towards investments in physical infrastructure, health care and education would require more flexibility in running fiscal policy, unless one accepts a permanent level of lower economic growth.

Given these circumstances, any gains obtained through the reducing of the structural deficit would matter. According to the data in Table 4.2 above, an increase in the EU budget would impose a direct cost on Romania's public sector budget equivalent to between 0.1- 0.2% of GDP per year. That represents a significant amount if the structural deficit target is set to -0.5% of GDP. The medium and long-term budgetary effects are less clear due to the fact that an expected increase in government revenues, via higher expected output, could actually lower the budget deficit marginally[31]. But this still leaves open the question to what extent Romania would benefit from a potential increase in the EU budget given the additional short term costs to the budget, the need to meet the Fiscal Pact structural constraints and the dismal rate of EU funds absorption.

5. The Impact of EU Funds on Romania's Economic Growth and Employment

The assessment of the impact of EU funds on economic growth would depend to a great extent on the actual flows to the economy as a whole, the efficiency to which these funds are employed and the methodology employed to analyse their impact on the economy. Although the overall impact of EU funds in the economy should be positive, since, as Table 2.2 shows, these represent a net inflow of capital into the economy, there are a number of factors to be considered. First, there is the issue of timeframe under which the analysis is performed. For certain funds such as those aimed at building both human as well as physical capital, like enhancing infrastructure, there is a spillover effect in the economy which would be felt over time. Second, there is the issue of spending efficiency which is rather difficult to assess. Third, the use of an economic model in a dynamic setting which would capture the relevant interconnections among the economic variables of interest is desirable but difficult to build.

There is a relatively large empirical literature which studies the economic impact of EU Funds and the results are mixed. Boldrin and Canova (2001) for instance find that these are largely ineffective. On the other hand Checherita et al (2009) argue that although EU funds help to reduce, to some extent, income disparities their effect on output growth fails to be observed. In another study, Ederveen et al (2006) conclude that EU funds become effective only when they are accompanied by an appropriate institutional framework. By and large, the evidence that regions receiving structural and cohesion funds are behaving any differently from the remaining ones still needs to be validated in practice. Spain for instance, has been a

[31] A report by the ECFIN (2005) calculates that the fiscal impact of the EU financial flows in the medium-term should be favourable. However, the report acknowledges the challenges in restructuring budgetary and administrative procedures, to be able to absorb the projected payments, which could have an adverse effect on the expected outcome.

large recipient of structural and cohesion funds, nevertheless its competitiveness failed to improve to the extent that unemployment is expected to rise to over 24% in 2012.

For Romania the analyses which estimate the impact of EU funds on economic growth are scarce. These are usually considered as direct effects on aggregate demand. The methodology employed here is based on the multipliers method. Arguably, this way of estimation has its limitations. The GDP estimates are obtained by using a static framework so that dynamic effects are not considered. Moreover, the crowding out effect cannot be assessed. This is an important consideration for policy analysis as, at the aggregate level of the economy, the net and redistribution effects would matter. The implications of increased spending sometimes overlook the effect of the economy once this spending ceases. Thus, while the EU funds could provide a small stimulus to the economy in the short term, their medium and long term effects on the economy, from the point of view of the efficient allocation of resources, could be doubtful.

Another drawback of this methodology, which applies particularly to Romania, is the fact that the multipliers might overstate the economic effects of EU funds on the economy due to the observed systematic irregularities in spending EU funds as well as the existing cost misallocation under various operational programmes. There is also the issue of 'leakages'. The EC estimates from input-output (I/O) tables suggest that around a quarter of EU funds expenditure returns to the rest of the EU in the form of increased exports, on machinery and equipment in particular, as GDP and investment grow. This 'leakage' seems to be particularly large for countries which have lower production capacities, for Greece it represents 42% of structural aid and while for Portugal it is 35%. Given Romania's production capacity similarities with Greece and Portugal the 'leakage' is thus likely to be relatively high in Romania as well, and the multiplier methodology would overstate domestic economic effects of the EU funds. When interpreting the results, one needs to bear in mind all the above mentioned shortcomings.

The multipliers methodology uses data from the Romania's I/O table for the year 2008. It considers several sub-sectors which are deemed to be a proxy for EU funds spending under various operational programmes. The multipliers are presented in Table 5.1 below[32]. Essentially they could be interpreted as representing the GDP change in value that results from a 1 RON change in output delivered to a final user by the buying sectors on the left column. These sectors are proxied to represent spending undertaken under the seven operational programmes from Table 2.3. The I/O multipliers link the direct impact on an industry from a policy or investment decision to the indirect impact on its suppliers, suppliers of those suppliers, and so on and so forth. Multipliers can also reflect induced effects on the industrial economy from increased earnings, and thus spending, from wage earners in the directly and indirectly affected industries.

[32] It can be observed that the cumulative impact using the multipliers method is higher than the size of the initial spending. It is worthwhile remembering that the methodology overlooks issues related to the crowding out effects, substituted spending, disequilibrium effects or medium and long-term economic implications.

Table 5.1 Romania GDP Multipliers for Selected Sectors

	GDP		
	Direct	Indirect	Induced
Natural water; water treatment and supply services	0.64	0.29	0.88
Sewerage; waste collection, treatment and disposal activities; materials recovery; remediation activities and other waste management services	0.71	0.25	0.69
Constructions and construction works	0.69	0.26	0.51
Consultancy and related services; information services	0.8	0.16	0.4
Education services	0.83	0.14	0.87

Source: Author's Calculations

The GDP effects of EU funds can be approximated using the multipliers above and the EUR amounts attracted under each operational programme. Results are presented in Table 5.2:

Table 5.2 Estimated GDP Effects of the EU Funds for the period 2007-2012/Q1

	Cumulative attracted funds[a], 2007-2012/Q1	GDP			GDP
		Direct	Indirect	Induced	Total
	EUR Bn.	EUR Mill.	EUR Mill.	EUR Mill.	EUR Mill.
OP Regional	**1.04**	718	270	530	1518
OP Technical Assistance	**0.02**	17	3	23	42
OP Enhancing Admin. Capacity	**0.03**	25	4	26	55
SOP Enhancing Competitiveness	**0.43**	344	69	172	585
SOP Transport	**0.32**	221	83	163	467
SOP HR Development	**1**	830	140	870	1840
SOP Environment	**0.57**	385	154	447	986
Total	**3.42**	2539	723	2232	5494

Source: Author's Calculations; a - including pre-financing

Thus, while the cumulative attracted funds over the 2007-2012/Q1 period amounted to EUR 3.4 Bn. the overall impact of the Romanian economy could have been close to EUR 5.5 Bn. if both the indirect and induced effects were factored in. Table 5.3 below presents the summary of results, including the employment effects[33]. Interval estimates have been used, with the lower bound of the interval being the nominal value of the cumulative attracted funds (column 1 in Table 5.2) and the upper bound being set at the total multiplier value (last column in Table 5.2). The cumulative GDP effects range between EUR 3.4 and 5.5 Bn. which represent between 0.5 – 0.8% of GDP[34].

[33] These were computed using the production function approach.

[34] The GDP and employment analyses consider the effects of Operational Programmes alone. As shown in Table 2.2, net EU payments averaged to close to 1% of GDP over the 2007-2011 period. The latter estimate includes the effects of CAP subsidies.

Table 5.3 Summary of GDP and Employment Effects

GDP				Employment	
Cumulative, 2007-2012/Q1		Yearly Avg.		Cumulative, 2007-2012/Q1	Yearly Avg.
Bn EUR	% of GDP.	Bn EUR	% of GDP	Thous.	Thous.
3.4 – 5.5	0.5 – 0.8	0.65 – 1.05	0.5 – 0.8	100 - 185	19 - 35

Source: Author's Calculations

The cumulative employment effects for the period 2007 – end of March 2012, which measure the number of full time equivalent jobs *maintained* in the economy, range from 100 to 185 thousands. This implies a yearly average of between 19 and 35 thousand jobs.

The GDP effects are not far from estimates observed in other New Member States (NMS). Rosenberg and Sierhej (2007) estimate demand effects of the EU funds in these countries and show that the demand impact ranges from 0.5% of GDP in Central European countries to up to 1% of GDP in the Baltic States, where EU commitments and absorption have been high. It is worthwhile mentioning that the authors estimated a larger demand impact for Romania, which, in hindsight, failed to materialise.

The results in Table 5.3 show that GDP and employment effects of the EU funds on the Romanian economy have been modest so far. This raises another question, namely to what extent the EU funds help achieving their stated objective, namely fostering economic growth and promoting convergence. On the other hand it could be argued that Cohesion policy funds make it possible for Romania[35] to finance projects which would help it achieve 2020 targets in areas such as environment, climate change or renewable sources. The financing of such actions might not be undertaken without external support and thus could have an adverse impact on domestic economic growth perspectives.

6. Concluding Remarks and Policy Implications

The current EU budget negotiations for the 2014-2020 period are of great importance as they set political priorities for future years. As it often happened during past negotiations, each EU member country will very likely attempt to pursue its own interests as much as it can. In these times of fiscal austerity net contributor countries tend to support a freeze in the EU budget rather that an increase. The former stance is more consistent to the general direction followed by fiscal policies in the EU member countries that pursued fiscal stabilisation programmes. It may appear inconsequent that countries which adopted austerity policies in order to reduce their budget deficits would support an increase in the EU budget. One line of argument in favour of this approach could stress the importance of EU Funds in supporting economic growth. However, this may work for countries which have exceptionally high absorption rates and face serious financing constraints. But this is hardly the case for any EU member country, and in particular for those who benefit the most from Structural and Cohesion funds.

[35] See Annex 1.

The current negotiating position of Romanian authorities is one which supports an increase in the EU budget, favouring the proposal put forward by the EC. This stance is less surprising given that Romania is a net beneficiary of EU funds. However, it is at odds with the country's poor track record of EU funds absorption. Given these circumstances there are a number of issues which need to be carefully considered.

In the first place, there are important fiscal implications for the Romanian budget. An increase in the EU budget would lead to an increase in Romania's financial commitments. These would come mainly from two sources: increased contributions towards the EU budget and higher amounts needed to co-finance EU projects. If the EU budget was approved in the current form, i.e. as it was put forward by the EC in 2011, it could raise annual domestic budgetary costs by between 0.1- 0.2% of GDP, as the analysis in this paper has shown. This increase does not include the advance payments from the budget. Due to the fact that there is a time lag between the moment the advance payments are paid and the moment in which the EU funds are actually disbursed, the budget deficit gap could widen, temporarily, even further.

As one would expect, changes in Romania's GDP growth rates or the EU funds co-financing rates could have important budgetary effects. The Fiscal Pact, to which Romania is a signatory, sets a ceiling for the structural budget deficit at -0.5% of GDP. The Romanian authorities may be able to bring its structural deficit below the Fiscal Pacts ceiling sometime after 2014 but, given the current structure of government spending, they could face serious challenges in maintaining the deficit at that level on a *permanent basis*. Future financial commitments to social security as well as the required financial outlays towards investments in physical infrastructure, health care and education would constrain the budgetary policy.

Advocating an increase in the EU budget would make little sense unless the absorption rate increased at such an impressive pace over the coming years that it would get close to 100%[36]. In the light of the recent country's experience this looks unlikely. The whole EU absorption funds process has come to an almost standstill in 2012 as audit exercises performed by the EU revealed numerous irregularities, notably over spending EU funds. Some of the current obstacles in the EU funds absorption are likely to persist as there are constraints which relate, for instance, to human capital development or the institutional set-up. Both would require substantial changes – which are bound to take time – if the process of the EU funds is to become much more efficent.

Improving substantially the absorption capacity should be paramount. This relates to Romania's ability to spend its allocated structural funds in an effective and efficient way. The absorption capacity can be thought along three components: macroeconomic, administrative and financial. Among the three, administrative absorption capacity is clearly the most flawed and could be subject to marked improvement. The Romanian authorities have taken a number of measures recently. There have been defined priority action plans in the areas of project

[36] Of course, one could argue that, by simply asking for a larger EU budget Romania follows in fact a negotiating strategy which would give the country more bargaining power. But again, this strategy might work if the EU funds absorption rate was close to 90-100%. What matters in the end is the effective absorption rate.

management and financing and public procurement. Standard bidding documents in key sectors have also been developed. However, as mentioned before, there are issues which would take a longer time to sort out, such as enhancing the expertise capacity at central and local administration. The scarcity of qualified personnel at the local level of public authorities also impacts negatively on the quality of strategic planning, designing and enforcement of multi-annual budgets. This aspect is strongly related to the financial absorption capacity, which defines the extent to which the supported regions are able to co-finance the projects. The higher the share of EU payments in GDP, the higher co-financing requirements would be.

The management of EU funding is due to change from 2014 onwards. This would have important implications for the overall process of EU funds absorption. Romania would need to prepare a Partnership Contract with the EC, where it would assess its national development needs and define its priorities for the use of EU funds so that the latter could be used more efficient in meeting the Europe 2020 targets. Thus, Romania would need to commit itself to a set of investment priority plans which would need to be in line with its economic growth objectives. The quantification of these investment needs would be an invaluable input in the evaluation of the country's EU-funding needs. However, the whole process may prove to be a challenging exercise unless sustained efforts are made to improve the whole assessment process. Poor planning and the setting of uncorrelated strategic objectives in the National Development Plan (NDP) 2007-2013 were one of the main causes of the poor absorption of EU funds. They often differed from the objectives laid down in the Operational Programmes leading to a funds allocation mismatch.

Higher effective EU funds absorption alone is not sufficient. These should be directed towards the appropriate projects and be successful in meeting the objectives for which have been designed. According to the estimates in this analysis, the impact of EU funds on Romanian GDP and employment appear to have been below initial expectations. Part of the reason is the low rate of absorption rate. But their efficient use matters considerably.

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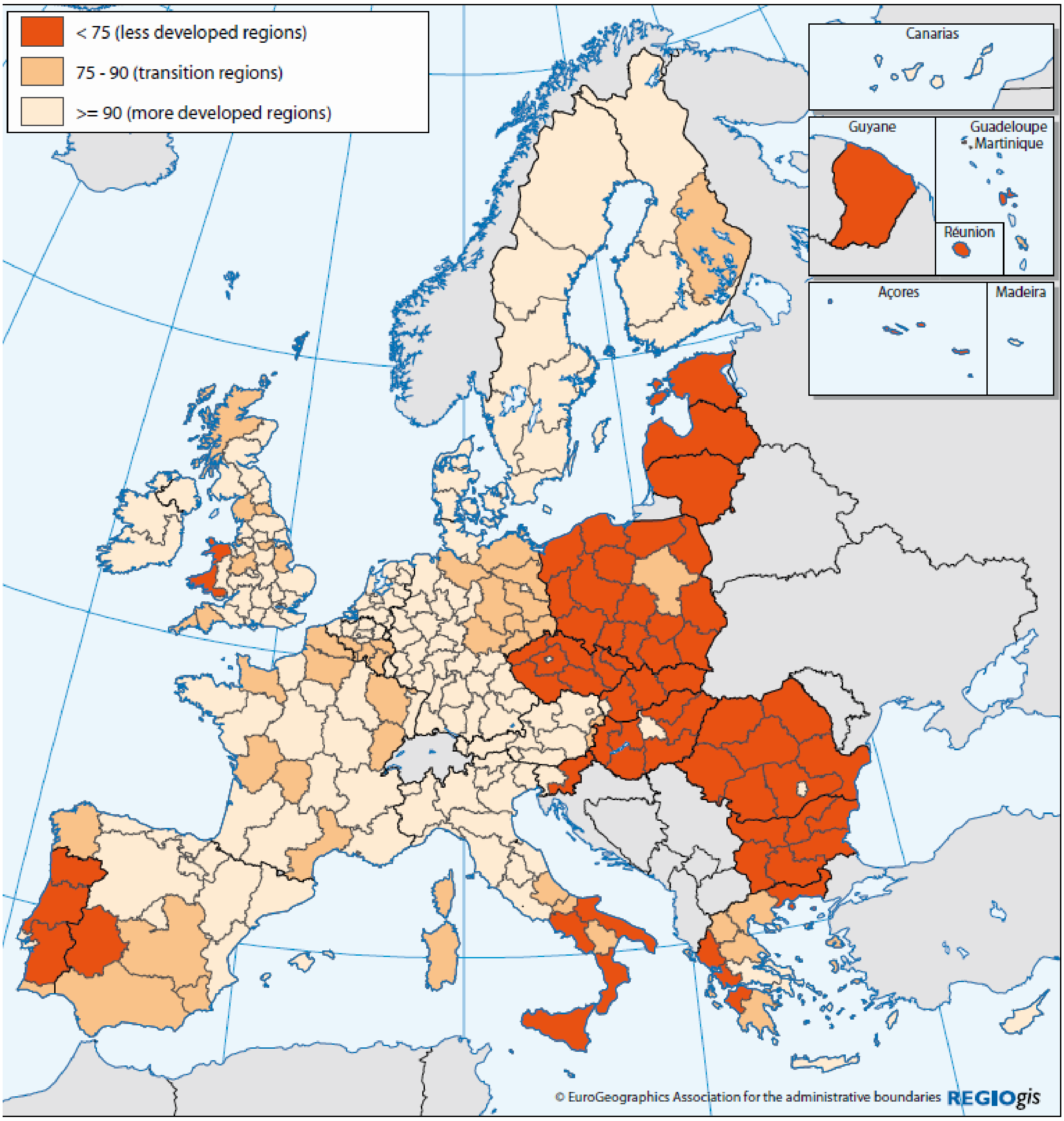
Annex 1. The EU Members Eligibility for EU Funding for the 2014-2020 Fiscal Exercise.

Eligibility simulation 2014-2020

GDP/head (PPS), index EU27=100



Source: EU 2011 (a).

Annex 2. The EU Budget for the current and next MFF (2011 prices, EUR Billion)

Table A 2.1. The EU Budget for the 2007-2013 Period[37]

		2007	2008	2009	2010	2011	2012	2013	*Total 2007-2013*
Sustainable Growth, *of which:*		58.22	59.43	60.77	61.54	62.61	64.25	65.91	432.75
	Competitiveness	9.40	10.10	10.84	11.62	12.48	13.39	14.36	82.19
	Cohesion	48.82	49.33	49.94	49.92	50.14	50.86	51.56	350.56
Preservation and Managm. of Natural Resources		62.65	61.89	61.14	60.42	59.70	58.99	58.28	423.07
Citizenship, freedom, security and justice		1.28	1.38	1.49	1.63	1.79	1.96	2.18	11.70
EU as a global player		7.16	7.46	7.78	8.11	8.46	8.82	9.20	56.99
Administration		7.66	7.86	8.03	8.18	8.34	8.49	8.75	57.32
Total appropriations (commitments)		137.44	138.24	139.44	139.89	140.90	142.51	144.32	982.74
	as % of GNI	1.10	1.08	1.06	1.04	1.03	1.02	1.00	1.05

Source: Adapted from the Council of European Union (2005)

Table A 2.2. The EC Proposed Budget for the 2014-2020 Period

		2014	2015	2016	2017	2018	2019	2020	*Total 2014-2020*
Sustainable and Inclusive Growth, *of which:*		64.70	66.58	68.13	69.96	71.60	73.77	76.18	490.91
	Cohesion	50.46	51.54	52.54	53.61	54.80	55.96	57.11	376.02
Sustainable Growth: Natural Resources		57.39	56.53	56.53	54.86	53.84	52.83	51.78	382.93
Security and Citizenship		2.53	2.57	2.61	2.65	2.69	2.73	2.76	18.54
Global Europe		9.40	9.65	9.85	9.96	10.15	10.38	10.62	70.00
Administration		8.54	8.68	8.80	8.94	9.07	9.23	9.37	62.63
Total appropriations (commitments)		142.56	144.00	145.09	146.37	147.34	148.93	150.72	1025.0
	as % of GNI	1.08	1.07	1.06	1.06	1.05	1.04	1.03	1.05

Source: European Commission 2011b

[37] Originally, amounts in Table A2.1 were expressed in 2004 prices. To obtain figures which could be directly compared across the two tables, the amounts from the initial document have been converted into 2011 prices using the cumulative inflation coefficient for the 2005-2011 period of 14% (given by the GDP deflator)

Annex 3. Romania's Budgetary Implications of EU Contributions and Projects Co-financing

Scenario 1 assumes a freeze in the EU budget, implying that the EU budget remains unchanged compared to the 2007-2013 period. It also assumes a lower GDP growth for the Romanian economy, averaging 2% per year and maximum co-financing rates.

In all scenarios EAFRD co-financing rate is kept at 30% but assumes that public financing is needed to co-finance only 25% of all funds earmarked for EAFRD. Also, the EU Funds absorption rate is assumed to be 100%.

Table A 3.1 Scenario 1, EU Budget Freeze, Low GDP Growth, Max. EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	161.8	171.7	182.1	193.2	204.9	217.4	230.6
Contribution to the EU	Bn EUR	1.5	1.6	1.7	1.8	1.9	2.1	2.2
Cohesion Funds Contribution[a]	Bn EUR	0.20	0.29	0.39	0.46	0.50	0.54	0.58
EAFRD contribution[b]	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.29	0.38	0.47	0.55	0.59	0.62	0.66
	As % of GDP	0.18	0.22	0.26	0.28	0.29	0.29	0.29
Overall budgetary cost, including EU contribution	Bn EUR	1.82	2.01	2.20	2.39	2.53	2.69	2.85
	As % of GDP	1.13	1.17	1.21	1.23	1.24	1.24	1.24

Source: Author's Calculations

a - Cohesion Funds co-financing rate = 15%, b - EAFRD co-financing rate = 30% but assuming that public financing is needed for only 25% of all EAFRD funds; EU Funds absorption rate = 100%.

Scenario 2 assumes a freeze in the EU budget, implying that the EU budget remains unchanged compared to the 2007-2013 period. GDP growth is also low, averaging 2% per year but co-financing rates are increased as follows, for CF the co-financing rate is set to 30% and for EAFRD to 45%.

Table A 3.2 Scenario 2, EU Budget Freeze, Low GDP Growth, Lower EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	161.8	171.7	182.1	193.2	204.9	217.4	230.6
Contribution to the EU	Bn EUR	1.5	1.6	1.7	1.8	1.9	2.1	2.2
Cohesion Funds Contribution[a]	Bn EUR	0.40	0.58	0.77	0.93	1.00	1.07	1.15
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.49	0.66	0.86	1.01	1.09	1.16	1.24
	As % of GDP	0.30	0.39	0.47	0.52	0.53	0.53	0.54
Overall budgetary cost, including EU contribution	Bn EUR	2.02	2.29	2.59	2.85	3.03	3.23	3.43
	As % of GDP	1.25	1.34	1.42	1.47	1.48	1.48	1.49

Source: Author's Calculations; a - Cohesion Funds co-financing rate = 30%

Table A 3.3 Scenario 3, EU Budget Freeze, High GDP Growth, Max. EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	165.0	176.8	189.3	202.8	217.3	232.7	249.3
Contribution to the EU	Bn EUR	1.6	1.7	1.8	1.9	2.1	2.2	2.4
Cohesion Funds Contribution	Bn EUR	0.20	0.29	0.39	0.46	0.50	0.54	0.58
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.29	0.38	0.47	0.55	0.59	0.62	0.66
	As % of GDP	0.17	0.21	0.25	0.27	0.27	0.27	0.27
Overall budgetary cost, including EU contribution	Bn EUR	1.85	2.05	2.27	2.48	2.65	2.83	3.03
	As % of GDP	1.12	1.16	1.20	1.22	1.22	1.22	1.22

Source: Author's Calculations

Table A 3.4 Scenario 4, EU Budget Freeze, High GDP Growth, Lower EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	165.0	176.8	189.3	202.8	217.3	232.7	249.3
Contribution to the EU	Bn EUR	1.6	1.7	1.8	1.9	2.1	2.2	2.4
Cohesion Funds Contribution	Bn EUR	0.40	0.58	0.77	0.93	1.00	1.07	1.15
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.49	0.66	0.86	1.01	1.09	1.16	1.24
	As % of GDP	0.29	0.38	0.45	0.50	0.50	0.50	0.50
Overall budgetary cost, including EU contribution	Bn EUR	2.05	2.34	2.66	2.94	3.15	3.37	3.61
	As % of GDP	1.24	1.33	1.40	1.45	1.45	1.45	1.45

Source: Author's Calculations

Table A 3.5 Scenario 5, EU Budget Increase, Low GDP Growth, Max. EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	161.8	171.7	182.1	193.2	204.9	217.4	230.6
Contribution to the EU	Bn EUR	1.5	1.6	1.7	1.8	1.9	2.1	2.2
Cohesion Funds Contribution	Bn EUR	0.24	0.34	0.47	0.57	0.63	0.68	0.74
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.33	0.44	0.56	0.66	0.72	0.77	0.83
	As % of GDP	0.20	0.25	0.31	0.34	0.35	0.36	0.36
Overall budgetary cost, including EU contribution	Bn EUR	1.86	2.07	2.29	2.50	2.67	2.84	3.02
	As % of GDP	1.15	1.20	1.26	1.29	1.30	1.31	1.31

Source: Author's Calculations

Table A 3.6 Scenario 6, EU Budget Increase, Low GDP Growth, Lower EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	161.8	171.7	182.1	193.2	204.9	217.4	230.6
Contribution to the EU	Bn EUR	1.5	1.6	1.7	1.8	1.9	2.1	2.2
Cohesion Funds Contribution	Bn EUR	0.47	0.69	0.93	1.15	1.26	1.37	1.48
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.56	0.78	1.02	1.24	1.35	1.46	1.57
	As % of GDP	0.35	0.46	0.56	0.64	0.66	0.67	0.68
Overall budgetary cost, including EU contribution	Bn EUR	2.10	2.41	2.75	3.07	3.30	3.52	3.76
	As % of GDP	1.30	1.41	1.51	1.59	1.61	1.62	1.63

Source: Author's Calculations

Table A 3.7 Scenario 7, EU Budget Increase, High GDP Growth, Max. EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	165.0	176.8	189.3	202.8	217.3	232.7	249.3
Contribution to the EU	Bn EUR	1.6	1.7	1.8	1.9	2.1	2.2	2.4
Cohesion Funds Contribution	Bn EUR	0.24	0.34	0.47	0.57	0.63	0.68	0.74
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.33	0.44	0.56	0.66	0.72	0.77	0.83
	As % of GDP	0.20	0.25	0.29	0.33	0.33	0.33	0.33
Overall budgetary cost, including EU contribution	Bn EUR	1.89	2.12	2.36	2.59	2.78	2.98	3.20
	As % of GDP	1.15	1.20	1.24	1.28	1.28	1.28	1.28

Source: Author's Calculations

Table A 3.8 Scenario 8, EU Budget Increase, High GDP Growth, Lower EU Co-financing Rate

		2014	2015	2016	2017	2018	2019	2020
GDP	Bn EUR	165.0	176.8	189.3	202.8	217.3	232.7	249.3
Contribution to the EU	Bn EUR	1.6	1.7	1.8	1.9	2.1	2.2	2.4
Cohesion Funds Contribution	Bn EUR	0.47	0.69	0.93	1.15	1.26	1.37	1.48
EAFRD contribution	Bn EUR	0.09	0.09	0.09	0.09	0.09	0.09	0.09
Budgetary Cost, Cohesion & EAFRD only	Bn EUR	0.56	0.78	1.02	1.24	1.35	1.46	1.57
	As % of GDP	0.34	0.44	0.54	0.61	0.62	0.63	0.63
Overall budgetary cost, including EU contribution	Bn EUR	2.13	2.46	2.82	3.16	3.41	3.67	3.94
	As % of GDP	1.29	1.39	1.49	1.56	1.57	1.58	1.58

Source: Author's Calculations