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Absorption Capacity of EU Funded Projects / Programmes in Albania – A Literature Review

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ABSTRACT

Albania aspires to join the European Union and it holds the candidate status. In this process the EU supports financially the reforms to introduce the necessary political, economic and institutional reforms to bring them in line with EU standards. Since 1991 EU has given considerable amount of financial assistance to Albania. The purpose of this article is to make a literature review of the content of EU funds in supporting candidate and potential candidate countries and to define the absorption capacity and its aspects.

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1. INTRODUCTION

The EU is characterized by "increasing economic integration among nation-states with relatively similar levels of development" coupled with "different social, institutional, and technological features in regions" (Barca, Riccardo Crescenzi and Mara Giua 2 McCann and Rodríguez-Pose, 2012, p. 143). In order to support and strengthen the cooperation between the countries of the Western Balkans and the EU member states, based on the experiences of the countries that have become the EU member states, participation in EU support programs has turned out not only as a great strategy for the EU accession process, but also as a great contribution to the economic and political progress of the countries that use them (Tošović-Stevanović, 2016).

One of the prior objectives that The European Union has set itself is to assure equal income standards and economic development between member states and regions.

The EU provides focused pre-accession financial aid to the acceding country, candidate countries and to the potential candidates. This financial assistance is made available both, individual and multiple beneficiaries. It is intended to help these countries to introduce the necessary political, economic and institutional reforms to bring them into line with EU standards.

The reforms necessary for EU membership also serve to improve the lives of citizens in the beneficiary countries. A key aim of assistance is to support political reform, in particular institution building, strengthening the rule of law, human rights, protection of minorities and the development of civil society.
Before joining the EU, a country must have a functioning market economy, as well as the capacity to cope with competitive pressures and market forces within the EU. Assistance is therefore provided to support economic reform, leading to faster growth and better employment prospects.

Furthermore, pre-accession aid encourages regional cooperation and contributes to sustainable development and poverty reduction. EU funding is designed to facilitate medium to long-term changes in society and the economy. The pace of reform and that of the accession process are closely related. The EU provides funding for a broad range of projects and programmes covering areas such as:

- regional & urban development

- employment & social inclusion
- agriculture & rural development
- maritime & fisheries policies
- research & innovation
- humanitarian aid

2. THE MAIN FINANCIAL MECHANISMS OF THE EU

Funding is managed according to strict rules to ensure there is tight control over how funds are used, and that the money is spent in a transparent, accountable manner.

As a group, the 28 EU Commissioners have the ultimate political responsibility for ensuring that EU funds are spent properly. But because most of the funding is managed within the beneficiary countries, responsibility for conducting checks and annual audits lies with national governments.

Over 76% of the EU budget is managed in partnership with national and regional authorities through a system of "shared management", largely through 5 big funds - the Structural & Investment Funds. Collectively, these help to implement the Europe 2020 strategy.

- European Regional Development Fund (ERDF) – regional and urban development
- European Social Fund (ESF) – social inclusion and good governance
- Cohesion Fund (CF) – economic convergence by less-developed regions
- European Agricultural Fund for Rural Development (EAFRD)
- European Maritime and Fisheries Fund (EMFF)

In order to achieve its strategic objectives, the European Union (EU) has set up two different Modalities of financial instruments

A. the indirect management, which includes: Structural Funds
B. the direct management, which includes: EU direct funding and External assistance financial instruments

The difference between direct and indirect funding

To the "**indirect funding**" belong the so-called "Structural Funds" and "Cohesion Fund", which are financial tools set up to implement the Cohesion policy, are also referred to as the Regional policy of the European Union. They aim to reduce regional disparities in terms of income, wealth and opportunities. Europe's poorer regions receive most of the support, but all European regions are eligible for funding under the policy's various funds and programmes.

The indirect funding: The Structural funds

The Structural funds includes three objectives;
1. Convergence Objective
2. Regional Competitiveness and Employment Objective
3. Territorial Cooperation Objective

and three funds:

1. European Regional Development Fund (ERDF)
2. European Social Fund (ESF)
3. The Cohesion Fund

- **European Regional Development Fund (ERDF)**

European Regional Development Fund (ERDF) was set up in 1975 and it became the main instrument of EU regional policy. ERDF objectives are, mainly, the promotion of structural adjustment and development of the backwards regions, supporting the economic reconversion, the development of regions with structural problems, including declining industrial regions, urban areas with economic delays, or areas dependent on fishery or certain services. Through ERDF are financed productive investments that contribute to the creation of jobs, mainly, through investments in SMEs, infrastructure, local human capital development etc.

The ERDF focuses its investments on several key priority areas. This is known as 'thematic concentration':

- Innovation and research;
- The digital agenda;
- Support for small and medium-sized enterprises (SMEs);
- The low-carbon economy.

The ERDF resources allocated to these priorities will depend on the category of regions:

- In more developed regions, at least 80 % of funds must focus on at least two of these priorities;
- In transition regions, this focus is for 60 % of the funds;
- This is 50 % in less developed regions.

- **European Social Fund (ESF)**

The ESF invests in people, with a focus on improving employment and education opportunities across the European Union. It also aims to improve the situation of the most vulnerable people at risk of poverty. European Social Fund (ESF) was set up in 1958. It aims at improving employment opportunities in the single market through increasing the mobility and facilitating the adjustment to the industrial changes, particularly through vocational training and recruitment systems. Thus, it strengthens economic and social cohesion and it contributes to “European Employment Strategy”. Through “Convergence” and “Regional Competitiveness and Employment” Objectives, ESF supports actions related to the followings: 1. increasing the adaptability of employers, SMEs and entrepreneurs; 2. improving the access to employment and sustainable inclusion on the labor market of inactive persons, unemployment prevention on long term and work activity prolongation; 3. strengthening the social inclusion of disadvantaged categories for a sustainable integration on the labor market and fighting against discrimination; and 4. strengthening the human resources.

- **The Cohesion Fund**

The Cohesion Fund is aimed at Member States whose Gross National Income (GNI) per inhabitant is less than 90 % of the EU average. It aims to reduce economic and social disparities and to promote sustainable development. The cohesion policy is defined by its scope, namely, to support the process of reducing the gaps between EU’s mode developed regions and member states, and those less developed. It offers them instruments (funds) aimed to finance their development goals and activities which, on the one hand, arise from the Europe 2020 strategy but at the same time, cover numerous problematic areas in the development path of these regions (lack of adequate infrastructure, entrepreneurship, unemployment, etc.) (Kersan-Škabić & Lela Tijanić, 2017).

Principles of EU Cohesion policy

(I) The European Cohesion policy and the implementation of the structural instruments are based on the following basic principles:

1) **Partnership principle** – Community action complement and support measures at the national level. The measures supported should result from close cooperation and consultations between the European Commission and the Member State. The central and regional authorities in the Member State and the socioeconomic partners should be actively involved in the process.

2) **Coordination** – the European commission and the member state ensure coordination and lack of duplication of financing available under the different financing instruments.

3) **De-centralisatio**n – in accordance with this principle competencies about the implementation of the funds are transferred from the Commission to the member state;

4) **Complementarity** – EU funding should complement and not replace allocated national resources.

The direct funding can be divided in two main areas:

- **The European programmes** which allow the Member States to cooperate, even if most of them are also open to the participation of other countries like the EFTA countries (Norway, Iceland and Lichtenstein) the potential and candidate countries, Switzerland and other third countries;
- **The external assistance** programmes which represent the legal framework of the EU's external assistance to Third and Developing countries

3. EXTERNAL ASSISTANCE PROGRAMMES

The external assistance programmes represent the legal framework of the EU's external assistance to developing countries. The EU's external policies, including EU development cooperation, are governed by a multitude of Council and European Parliament regulations and decisions. These regulations, referred to as 'legal instruments', provide the legal basis for all EU programs which provide external assistance.

There are two types of EU legal instrument:

- geographical instruments that apply to a specific region or country,
- thematic or 'horizontal' instruments that concern a specific theme or sector of development co-operation and apply to all external relations.

Geographical programmes focus on development priorities defined for a specific country or region. The Commission draws up strategy papers in cooperation with the beneficiary countries. They are based on the specific needs and situation of regions and partner countries and take their performance into account.

The multiannual indicative programmes set out priority areas and financial allocations and serve as the basis for the implementation of aid.

Four instruments to support specific policies with a geographical focus:

- The Development Co-operation Instrument (DCI)
- The Instrument for Pre-accession Assistance (IPA)
- The European Neighbourhood and Partnership Instrument (ENPI)
- The Instrument for Co-operation with Industrialized Countries (ICI)

In addition to regional and country-based assistance, the EU supports development through programmes with a specific thematic focus. Thematic programmes are always implemented using a horizontal approach and are coherent with and complementary to geographic instruments.

The results of EU funded thematic programmes are found all over the world. These programmes are about protecting human rights, promoting democracy, eradicating poverty, fostering self-sufficiency in food production, improving education and protecting health and the environment.

The programmes are implemented based on thematic multiannual indicative programmes which specify the priorities and overall funding for a period of 3 years and annual action programmes which further establish the specific projects to be financed. The EU has mainly five thematic instruments for external cooperation and channelling external aid.

Five instruments with horizontal/thematic focus, which deal with major areas of EU external assistance on a global basis:

- The European Instrument for Democracy and Human Rights (EIDHR)
- The Instrument for Stability (IfS)
- The Instrument for Humanitarian aid
- The Macro-Financial Assistance Instrument (MFA)
- The Instrument for Nuclear Safety Co-operation (INSC)

3.1 Absorption capacity and factors that influence its performance

'The concept of absorptive capacity, whose foundations were originally designed in the context of firm theory, can be extended to more complex institutions, such as countries and regions' (Caragliu & Nijkamp, 2008, p.1). As to the absorption capacity notion, Boot et al. (2001) make a first analysis in which the absorption capacity notion is presented systematically. In these authors' view, the absorption capacity can be defined as being "the extent to which a member state is capable of effectively and efficiently consuming the financial resources allocated through the structural funds." Absorption capacity is also seen as one of the constraints that influence the growth in Less Developed Countriess; however, it also serves as a tool to measure the scale of the development assistance provided to them (Clemens, Radelet, 2003).

In order to use all the resources allocated from EU funds, it is necessary to have a state created institutional system to ensure an absorption capacity capable of managing the given resources (Begg, 1999). Conversely, it is also required to have absorption capacity from the beneficiaries to design and program projects. Based on past experiences, the Commission arrived to the conclusion that countries have a limited capacity to absorb external investment support effectively and efficiently. Šumpíková, Pavel, and Klazar (2003), Zaman and Georgescu (2009) identified three approaches to analyse absorption capacity:

1. *Macro-economic absorption capacity.* This capacity may be defined and measured in relation to the Gross Domestic Product (GDP). Thus, the Council Regulation no. 1260/1999 provides that the annual amount that a Member State may benefit from Structural Funds – together with assistance through the Cohesion Fund – must not exceed 4% of GDP.

   Other dimensions of the macroeconomic absorption capacity refer to: -the necessity of increase of the budget spending. The states that benefit from European funds have to provide higher budget expenditure in order to ensure the assumed co-funding; - the capacity to absorb the macroeconomic effects generated by the additional costs which will appear. These expenses will determine an increase of the aggregated offer, especially of its component regarding the labor market. (Simina, 2015)

2. *Financial absorption capacity*, defined as the ability to co-finance the programs and projects supported by the EU, to plan and guarantee these national contributions in multi-annual budgets, and to collect contributions from the partners involved in various programs and projects;

3. *Administrative capacity*, can be defined as the ability and skill of central, regional and local authorities to prepare suitable plans, programmes and projects in due time, to decide on programmes and projects, to arrange the co-ordination among principal partners, to cope with the administrative and reporting requirements, and to finance and supervise implementation properly, avoiding irregularities as far as possible. The capacity comprises structure, human resources, systems and tools.

Structure relates to the clear assignment of responsibilities and task of legal body, or within it at the level of departments or units and to supervisory and ancillary bodies, such as Monitoring Committees, auditing bodies, partnership, etc. This assignment refers to a range of EU funds tasks, including programming, implementation, management, evaluation and monitoring, financial management and control.

Human resources relate to the ability to detail tasks and responsibilities at the level of job descriptions, to estimate the number of qualifications of staff, and to fulfil the recruitment needs. Securing the timely availability of highly experienced, well skilled and motivated staff is a key success factor in management of any PEP.

Systems and tools relate to the availability of instruments, methods, guidelines, manuals, systems, procedures, forms, etc., which enable organizations to transform tacit and implicit knowledge (within the heads of individual people) into explicit knowledge that can be shared across organizations.

The absorption capacity only leads to a strong performance of the EU funds if economy, efficiency and effectiveness are taken fully into account [Wright and Nemec 2003]. The absorption capacity of EU funds is usually measured by "absorption rate", an indicator defined as the level of verified payments disbursed as percentage of the planned allocations (funding available) for a particular program, region or for a member state. Due to the importance of cohesion funding as an investment tool to foster development and competitiveness for many EU member states, the 100% absorption rate becomes a major concern for regional and central governments. Consequently, governments deployed efforts to prevent and manage the deficiency of absorption capacity (Horvat & Maier, 2004) and absorption bottlenecks (Kalman, 2002).

Analysis conducted so far about the effects of EU funding identified the so-called "absorption problems" (Kalman, 2002; Kalman, 2011, Dragan, 2008) which have to be carefully taken into consideration, by policy and decision makers:

- administrative absorption' problems – is resulting in a difference between transfers from EU budget under cohesion policy and the increase in the productive capital in the beneficiary region/member state;
- rent-seeking problem – it refers to the people who interfere for the use of EU funds with the view of gaining personal advantages and it becomes manifest through external forms of corruption at various levels (between national governments and EC, between governments and various organizations having interest in accessing EU funding etc.);
- timing related problems – EU funding in infrastructure projects consists in long-term focused public investment and may have significant opportunity costs in the short-run, such as delays

in private investment decisions or private investment even being crowded out by public sector (Dragan, 2008);

- prioritization problems – the inability of the regional/central governments to define a limited number of investment priorities may lead to suboptimal use of EU funding.

4. Instrument of Pre-Accession (IPA)

The new Instrument for Pre-Accession Assistance (IPA II) sets a new framework for providing pre-accession assistance for the period 2014-2020, replacing the Instrument for Pre-accession Assistance I (IPA I). Before describing the main characteristics of IPA II, it is necessary to outline briefly the objectives and components of the IPA I so that we can see more clearly where and how IPA II differs from its predecessor. The first Instrument for Pre-Accession Assistance (IPA I) was an instrument designed to replace several European Union programmes and financial instruments (PHARE, PHARE CBC, ISPA, SAPARD, CARDS and the financial instrument for Turkey) with one single instrument and legal framework (Council, 2006). The IPA was made available to pre-accession countries, i.e. candidate and pre-candidate countries, not European Neighbourhood Policy (ENP) countries.

IPA funds had two main objectives:

1) Firstly, they were designed as a means of co-financing some of the expensive and difficult reforms that all candidate countries must undertake in order to prepare themselves for membership of the EU, and the full participation in all EU policy fields that comes with this (Council, 2006).
2) Secondly, they aimed to prepare countries for the post-accession receipt of the Structural and Cohesion funds that would help modernize their infrastructure and support long-term economic and social convergence within the Union in line with the Europe 2020 strategy

IPA I expired at the end of 2013. With a view to future accessions, the EU continues to offer candidate countries and potential candidates technical and financial assistance to overcome domestic challenges and develop in a sustainable fashion. The Instrument for Pre-Accession Assistance II (IPA II) is designed to create a single framework to achieve these ends, and to unite under the same instrument both candidate and potential candidate countries (Commission, 2011c, p.25; European Parliament & Council, 2014a, (2)). Currently, the EU is dealing with six candidate countries (Albania, the former Yugoslav Republic of Macedonia, Iceland3 , Montenegro, Serbia and Turkey) and two potential candidates (Bosnia and Herzegovina, as well as Kosovo under UNSCR 1244/994).

4.1 Albania and the EU Funds

With the signature of Trade and Co-operation Agreement between the EU and Albania in 1992, Albania became eligible for financial assistance under the EU's Phare programme and, from 2000, under the EU's CARDS financial assistance instrument. As from 1991 until 2001 Albania has benefited from EU funds around 912 mln EUR in form of grant. From 2001 until 2006 it has benefited from the Stabilization and Association Process grants of 280 mln EUR.

In year 2007 the European Union introduced a new financial instrument for candidate and potential candidate countries called Instrument for pre-accession (IPA) which covered financial assistance for a term of seven years (2007-2013). This assistance is provided on the progress made by the beneficiary countries and their needs shown in the evaluations and strategy papers by the EC. The financial assistance under IPA was designed to address the needs of the beneficiary countries within the context of pre-accession policy. The main aim of IPA is to support institution-building and the rule of law, human rights, including the fundamental freedoms, minority rights, gender equality and non-discrimination, both administrative and economic reforms, economic and social development, reconciliation and reconstruction, regional and cross-border cooperation and agriculture sector.

To insure effectiveness of the priorities defined according to the needs of the beneficiary countries IPA is composed of five components; 1) Transitional Assistance and Institutional Building(TAIB), 2) Cross-Border Cooperation(CBC), 3) Human Resource Development (HRD), 4) Regional Development(RD) and 5) Rural Development or IPARD. The first two components concern all beneficiary countries while the rest only to candidate countries. Therefore, until 2013 Albania could benefit only from the first two components, TAIB & CBC. The amounts of EUR spread during this program are shown in the table below.

The EU financial Assistance under IPA programme 2007-2013 to Albania has had an important role in improving the developments in areas of : strengthening of democratic institutions and the rule of law; promotion and protection of the fundamental rights and freedoms; public administration reform; reform in the field of justice and home affairs; modernization of the regulatory framework, including support for investment to equip key institutions whose infrastructures or capacity to monitor and enforce legislation need strengthening; establishment or reinforcement of financial control systems; strengthening of the market economy; development of civil society; establishment of social dialogue as an element of good governance and to promote fair and just working conditions; promotion of minority integration, reconciliation and confidence-building measures on all levels of society; improving environmental policy; improvement of access to financial facilities for small and medium- scale enterprises and public administrations; support for participation in community programmes; improvements in agriculture, infrastructure and cross border cooperation.

The new IPA approach which covers the period 2014-2020 and it differs from IPA I (2007-2013) because of its strategic approach. This new programme will provide for a stronger ownership by the beneficiaries through integrating their own reform and development agendas. In this regard, the EU will support Albania address and implement its Public finance management reform (2014-2020) as the Government priority for development and reforms. Reforming the public finances is like reforming the state as it involves many institutions and stakeholders. Under IPA II (2014-2020) the EU is intended to give Budget Support (BS) to Albania in order to implement sector reform in the public finance management, sector budget support in public administration reforms, VET, transport, Justice and Tourism and Environment.

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