



Regional Focus

A series of short papers on regional research and indicators
produced by the Directorate-General for Regional Policy

The financial execution of Structural Funds

By Rocco L. Bubbico and Nicola De Michelis

Contents

Introduction	1
1. Functioning of financial management	1
2. Long-term financial execution dynamics	2
3. Financial absorption in 2007-2013	3
4. The challenges of financial execution	5
5. Conclusions	6

Introduction

The financial execution of Structural Funds has become a key topic in recent debates about the functioning and the future of Cohesion Policy. Stakeholders are increasingly requiring effective delivery of quality policy measures and structural investments to overcome the economic downturn. Financial execution is a necessary but insufficient condition for effective policy implementation and there are concerns as regards the pace of programmes' implementation.

The purpose of this document is to provide a contribution to the debate on financial execution, showing:

- The functioning of the financial management of Cohesion Policy;
- The implementation dynamics and the current situation of the financial execution;
- The implementation obstacles being faced in the current period.

1. Functioning of financial management

The financial management system of Cohesion Policy is based on planning, management and control systems. Within this system, three different categories of payments are made by the Commission to Member States:

- Advances;
- Interim payments;
- Payment of the final balance.

Advances are provided by the Commission to Member States during the first three years (e.g. 2007-2009) of the programming period and range from 7.5% to 10.5% of the funds, depending on the country and the fund¹. As a consequence, at the beginning of the programming period, advances represent the cash provided to Member States to co-fund the start of programmes on the ground. The subsequent interim payments, in comparison, stem from requests from Member States for top-ups of those initial financial resources.

Once the final beneficiary of a programme utilises the funds for a project and submits the related expenditure declarations to the managing authorities, several steps are undertaken to control the eligibility and certify the expenditure. The statements of expenditure from various operational programmes are then collected and submitted by Certifying Authorities to the Commission three times a year. This process automatically results in a substantial delay between implementation in the field, e.g. the start of a project by a beneficiary, and financial execution, corresponding to the European Commission's registration of the claim request. Estimating this delay is difficult, since there is no immediate claim from the managing authorities to the Commission. In fact, the processes for claim submission vary substantially across Member States. In any case, the monitoring of these flows offers poor information about the implementation pace at both aggregate and decentralised level.

As a consequence, payments are not real-time or pertinent indicators for evaluating how the implementation of operational programmes is progressing on the ground. Although the Commission registers and reports the payments to Member States, this process is independent from the gradual payments made to project beneficiaries by the managing authorities of operational programmes, which are not tracked in real-time at European level.

¹ 7.5% - 9% for the ESF/ERDF and 7.5% - 10.5% for the CF. Source: Cohesion Policy 2007-2013 – Commentaries and official texts; available online at: http://ec.europa.eu/regional_policy/sources/docoffic/official/regulation/pdf/2007/publications/guide2007_en.pdf and Corrigendum of 7 April 2009 increasing the share established by the original regulation, available online at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:094:0010:0012:EN:PDF>

Other indicators, which cannot be considered as indicators of implementation in the field, are allocations to projects and commitments. To clarify the concepts, some summary explanations are provided in Table 1.

Table 1 - Lexicon of European Commission financial management

Decided	Allocated from the European Commission to the Member States; objectives and operational programmes
Allocated to projects	Managing authorities take the programming decision to allocate the funds decided upon to projects
Committed	The funds that have been committed to operational programmes by the Commission
Paid	The funds which are transferred by the Commission to the managing authorities

Source: authors

The experience of financial management at the European Commission shows that the claims are presented irregularly over the financial year, on more than three occasions, and increasingly towards the last quarter. The amount of each claim is extremely variable, since it is possible to aggregate the expenditure of multiple operational programmes in one single claim. Moreover, payments to Member States can be delayed, depending on the availability of the budget allocated to the relevant EC Directorates-General (Regional Policy and Employment). In particular, payments can be delayed until the following financial year if the annual budget of the Directorate has been fully utilised.

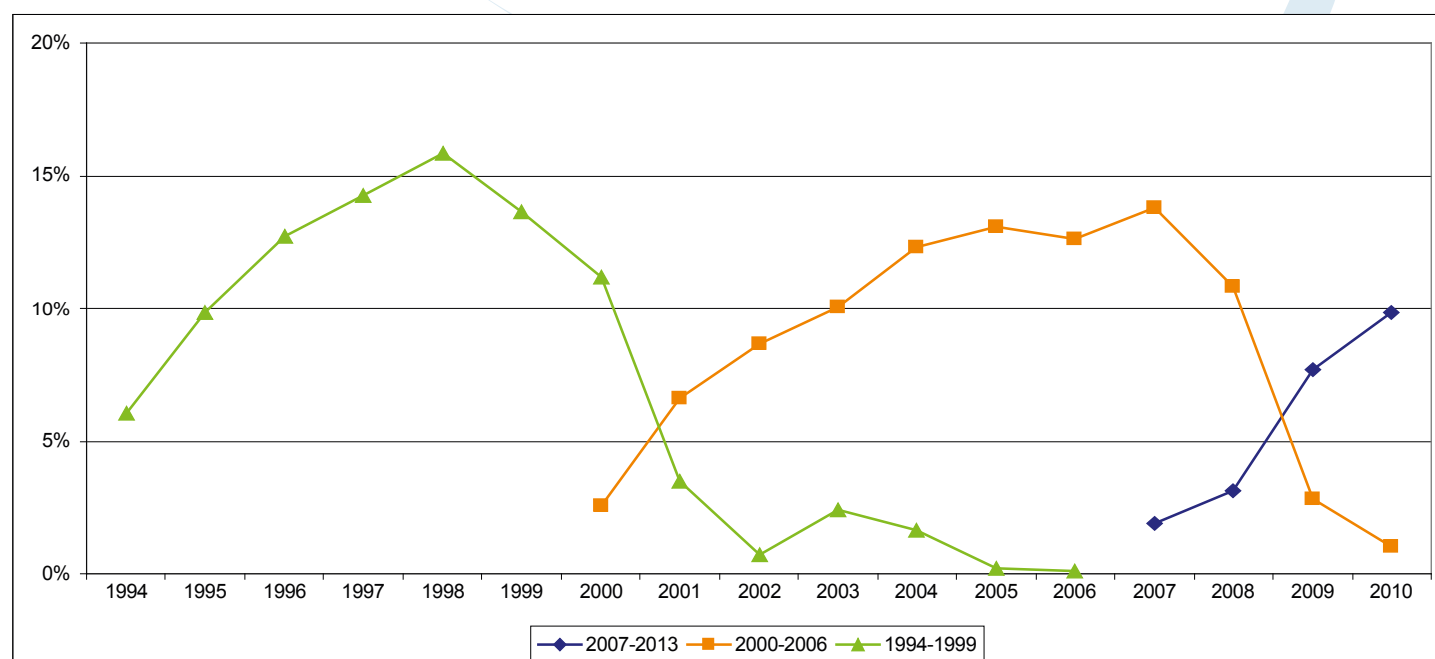
Financial flows are further regulated by the so-called decommitment rule, which states that if committed funds are not spent by the second or the third year following the year of budget commitment, they are lost. In other words, managing authorities with a fund allocation for year N must submit the claim application for payments from the funds of N by 31 December of year N+2. This rule includes an exception for EU-12 Member States, Portugal and Greece, which have until 31 December of year N+3².

2. Long-term financial execution dynamics

As Figure 1 shows, the financial absorption related to a single programming period changes substantially in the opening and closing years. Therefore, it is normal, in terms of financial flows, to have gaps in the trend due to the end of a programming period and the beginning of a new one. On the ground, however, the end of the programming period overlaps with the start of the new one and different programming periods run simultaneously under the respective authorities. Figure 2 shows the payments of the ERDF and ESF per capita in real terms at 2000 values. The long-term trend shows that payments per capita have been fairly stable in the last 15 years of Cohesion Policy's implementation. In fact, between 1996 and 2010 the payments per capita were constantly between EUR 42 and EUR 55 at 2000 values, reaching two peaks in 2003 and 2007.

Hence, at aggregate level, Figure 2 shows that the amount of payments over multiple periods is significantly less variable than the payments related to a single programming period. The financial 'take-off' of the new programmes compensates for the decline in payments referred to in the previous ones. This demonstrates clear stability in the trend of Cohesion Policy's investments on the ground, with no 'gaps' even for programming periods characterised by a slow or delayed start.

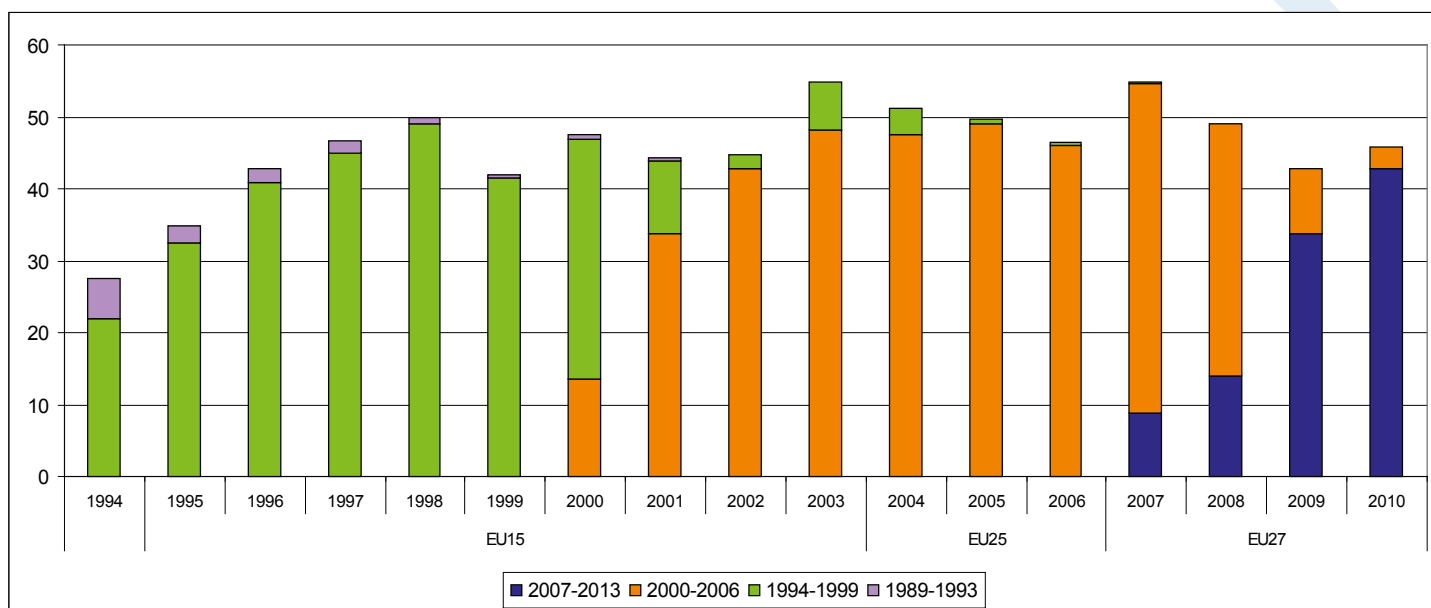
Figure 1 – Yearly financial execution over total allocation by period (ERDF and ESF)



Notes: the total in each period is below 100%, since the financial execution is lower than the total allocation for all periods analysed at 31.12.2010. The ESF-ERDF allocation to the EU-10 in 2004-2006 is included in the 2000-2006 total. Source: authors, elaboration of DG REGIO data. Extraction on 3.1.2011.

² This only applies between 2007 and 2010.

Figure 2 – Financial execution by programming period, euro per capita at 2000 prices (ERDF and ESF)



Source: authors, elaboration of DG REGIO and AMECO data. Extraction on 3.1.2011.

3. Financial absorption in 2007-2013

In terms of payments, between 2007 and 2010, EUR 152 billion were transferred (until 3 January 2011) from the EU to Member States for advance payments and reimbursement for Cohesion Policy projects. During this timeframe, 50% of the Commission payments (EUR 75.5 billion) were related to the 2000-2006 period. The total amount of advance payments and interim payments for the 2007-2013 period is only slightly higher (EUR 76 billion). The data show that the pace of 2007-2013 payments under the 2010 financial framework accelerated in comparison to previous years.

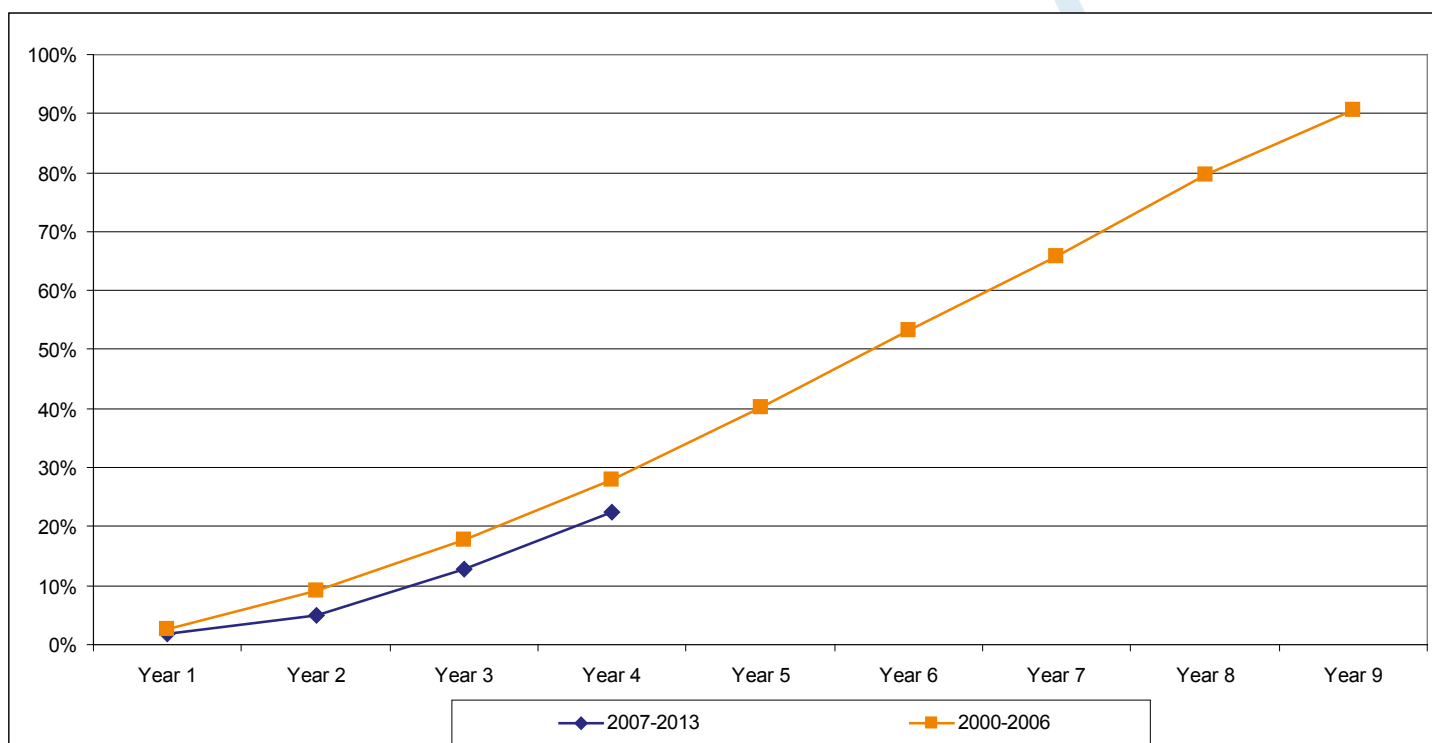
The current trend of financial execution for the ERDF and ESF in comparison with the previous period is provided in Figure 3 and 4. Figure 3 shows that the first years of 2000-2006 featured low absorption rates followed by increasing yearly expenditure in the central and final years of implementation. This stage is followed by the closure of the programmes, with significantly lower absorption due to closure procedures. The total execution in 2000-2006 reached over 90% after nine years, while it is expected to reach full execution with the completion of the closure procedures. The trend during the first years of 2007-2013 followed the same dynamic, although a small gap was generated in the first three years of implementation.

In the period 2000-2006 the combined ERDF/ESF expenditure was below 30% after four years of implementation. In comparison, the current expenditure rate is around five percentage points lower (22.6% vs. 27.9%). As Figure 4 shows, the fourth year of the 2007-2013 period (2010) is characterised by a process of catching-up for both the yearly and aggregate expenditure.

This gap can be explained by the different regulatory framework of 2007-2013 – analysed in the next section – which limits somewhat data comparability. Moreover, in the first years of 2007-2013 implementation, Member States gave priority to closing the period 2000-2006, thus creating pressure on administrative capacities.

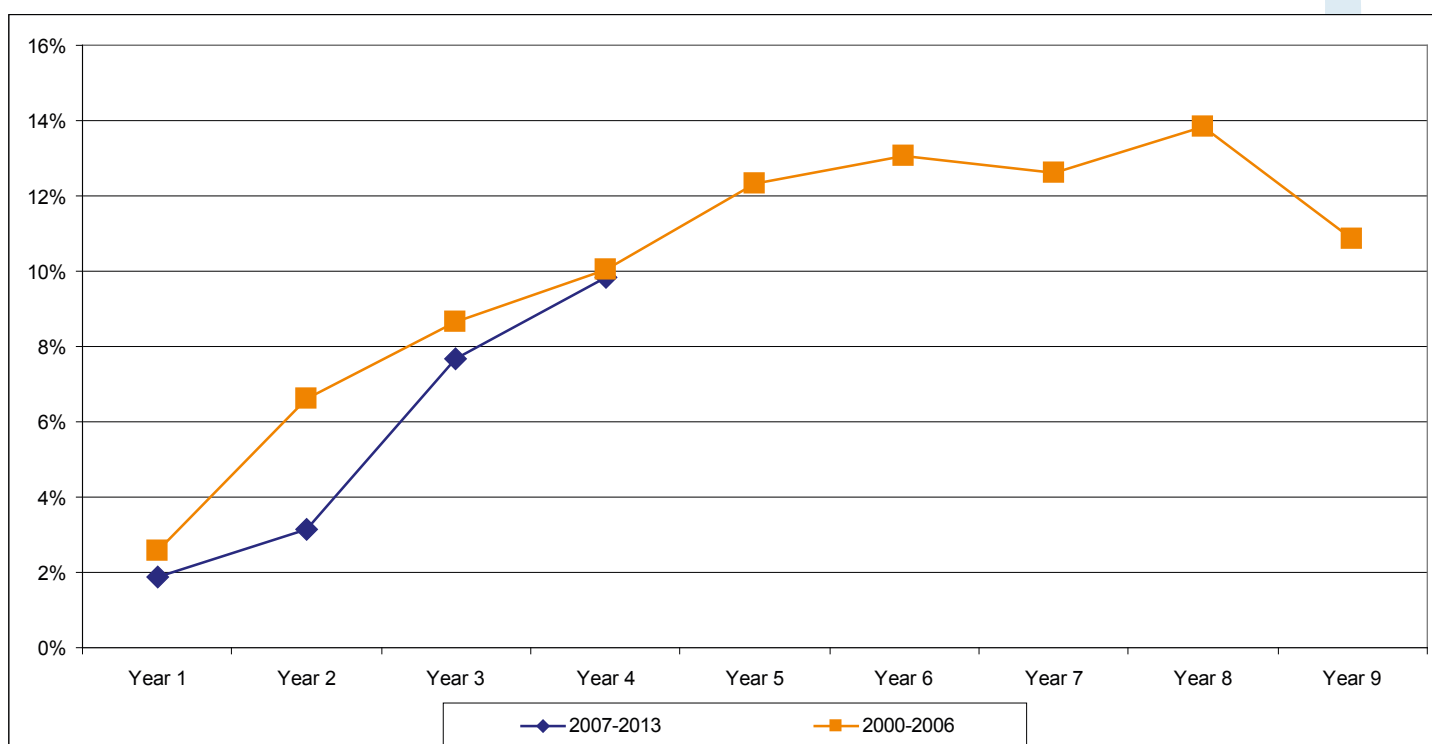
As to the Cohesion Fund, the full implementation system of the fund has changed from a project-based system to the current programme-based system. Therefore, while comparisons between the two periods need to be taken with some caution, the absorption rate at the end of 2010 (20.5%) was higher than the absorption in 2000-2006 after four years of implementation (17.8%).

Figure 3 - Aggregate absorption rate of total allocation (ERDF and ESF)



Note: the ESF-ERDF allocation to the EU-10 in 2004-2006 is included in the 2000-2006 total.
 Source: authors, elaboration of DG REGIO data. Extraction on 3.1.2011.

Figure 4 - Yearly payments of total allocation (ERDF and ESF)



Note: the ESF-ERDF allocation to the EU-10 in 2004-2006 is included in the 2000-2006 total.
 Source: authors, elaboration of DG REGIO data. Extraction on 3.1.2011.

4. The challenges of financial execution

As mentioned above, it is possible to mention several reasons in order to explain the evolution of financial implementation in the current period.

First, the new regulatory requirements have certainly caused a delayed start to the programmes on the ground and consequently delayed financial execution. The 2007-2013 Community Regulations were approved in mid-2006, followed by the Community Strategic Guidelines. The National Strategic Reference Frameworks were approved in 2007, followed by the negotiation and approval of the operational programmes. In 2007, 307 of the 317 operational programmes were decided.

Second, the new regulations established new rules, in particular Article 71 of Council Regulation 1083/2006, which states that, before the first interim payments and within one year of approval of the operational programme, an assessment report on the management and control systems should be submitted to and approved by the Commission. These documents were approved during the second and third year of the current period, thus further contributing to delayed implementation on the ground. The first compliance assessment (a necessary step for interim payments) was approved in July 2008, while the largest number of documents was approved in 2009. By January 2011, 313 out of 317 compliance assessments were approved and this is certainly contributing to the acceleration of financial execution as shown in Figure 5. It is also safe to say that this new system has contributed to reducing the error rate of Cohesion Policy as confirmed by the recent report from the Court of Auditors³, by establishing sound ex ante systems.

Third, an additional element to take into account is the relatively high proportion of large ERDF projects and Cohesion Fund sources in the total funding. The experience of Cohesion Policy shows that large projects need a longer time for preparation. As a result, there is a longer time delay for implementation and consequently payment claim registration. In fact, claims for large project payments started to be registered only during the 2010 financial year.

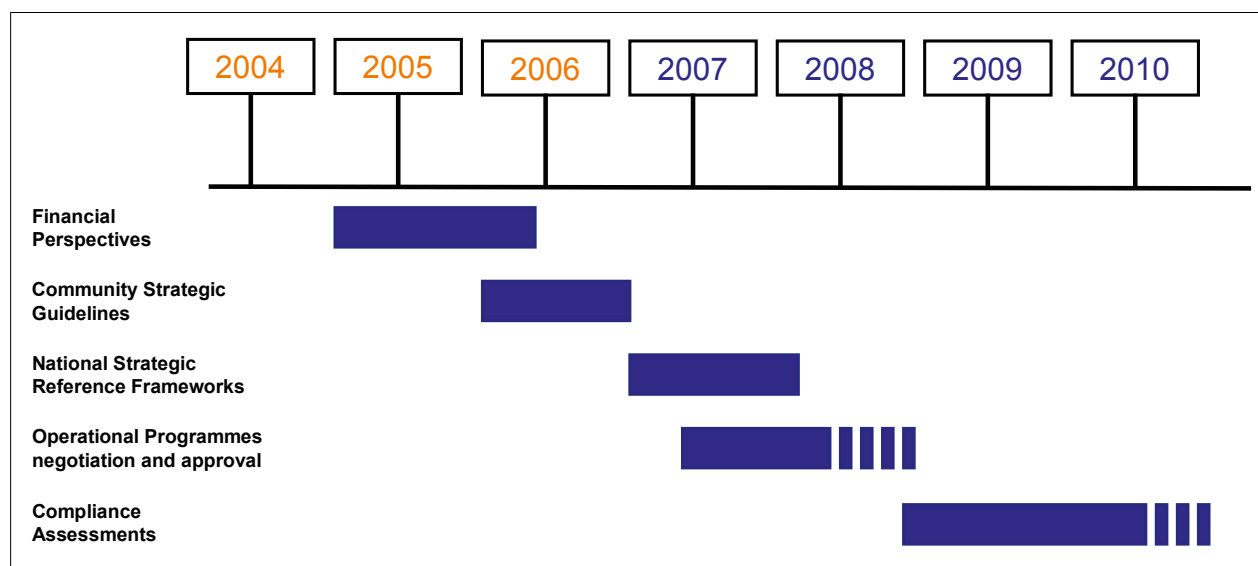
Fourth, as explained before (and shown in Table 2), national and regional authorities met some difficulties in the management of the two overlapping programming periods, since they had to, on the one hand, adapt administrative structures to new regulations and rules, and on the other, continue managing the previous period with largely the same administrative and human resources.

Table 2 – Policy implementation issues

	Financial management issues	Related administrative issues
Commission	<ul style="list-style-type: none"> • New legal requirements for financial control 	<ul style="list-style-type: none"> • Late adoption of regulation and strategic documents
Member States	<ul style="list-style-type: none"> • National co-funding • Management of two overlapping programmes • Large projects with long preparation 	<ul style="list-style-type: none"> • Lack of administrative capacity • Strategic focus on alternative, short-term national programmes

Source: adapted from COM(2010)110 final, Brussels, 31.3.2010, 'Cohesion Policy: Strategic Report 2010 on the implementation of the programmes 2007-2013'

Figure 5 – Timeline of 2007-2013 programming period



Source: authors

³ Court of Auditors Annual Report 2009, available online at <http://ec.europa.eu/portal/pls/portal/docs/1/5926723.PDF>

This process has been made even more complicated by insufficient experience, lack of administrative capacity and internal reorganisations processes of public administrations that undermine administrative continuity. Some major recipients of 2007-2013 ERDF and ESF budgets are new Member States, with relatively brief experience in managing Cohesion Policy.

Finally, the economic downturn has caused budget constraints that triggered two effects related to the implementation of Cohesion Policy. First, the budget consolidation strategies undertaken by Member States generated challenges in terms of ensuring the necessary national co-funding, especially for large ERDF and CF projects. They also put some pressure on the availability of additional national resources. Second, it has drawn the attention of policy-makers towards alternative countercyclical policies with less demanding conditions and rules, typically at national level. The Commission acknowledged this issue and tackled it by increasing the rate of advance payments in 2009.

5. Conclusions

A low level of financial execution is often associated with administrative problems, an insufficient strategic approach or implementation obstacles on the ground. Although in the long term, low absorption rates can reflect delays and can consequently be considered as indicators of institutional inefficiency, a short-term relation between a low level of financial execution and institutional problems or ineffective implementation cannot be demonstrated because of the features of the Structural Funds' financial system. As a consequence, a full understanding of the financial dynamics on the one hand, and of implementation processes on the other, is needed. However, because of the new regulation and decommitment rules, it is crucial to pay close attention to the timely utilisation of available funds.

Nevertheless, it is unquestionable that efficient absorption without meaningful programmes will not be enough to meet the objectives of European Cohesion Policy. As a consequence, a full picture of the success or failure of Cohesion Policy should not be based on financial data only, ignoring the effectiveness of the policy measures implemented and their consequences on regional development.

Acknowledgements

The authors would like to thank Michael Hill for his comments and contribution to this paper.

**Any questions, comments or contributions
should be sent to the following address:**

regio-papers@ec.europa.eu

Consult this website for further information:

http://ec.europa.eu/regional_policy/index_en.htm