

# **HOW THE INSTITUTIONAL SYSTEM CHARGED WITH REGIONAL DEVELOPMENT POLICY ACTUALLY IMPACT THE USE OF COHESION FUNDS AS REFLECTED BY A COMPARATIVE ANALYSIS OF POLAND AND HUNGARY**

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## **Abstract**

After ten years of membership visible differences in the way the two countries use development funds intended for convergence are beginning to evolve although both joined the European Union at the same time. Despite the similarities in the problems needing to be remedied through their regional development policies, identical timeframes and the proportionately equal development funds, there is an order of magnitude in the differences in the quantitative use of the cohesion funds in the final third of the seven-year programme. Hungary is nearly 20 percent behind Poland in absorption of the Cohesion Fund and the European Social Fund, and according to European Commission statistics published in November 2013 Poland is also ahead in accessing the Regional Development Fund. This paper is intended to explore institutional differences in the in the regional policies of the two countries, how they evolved, and how they were amended over time. My investigation covers the institutions and fund usage starting with accession to the European Union and ending with the programme cycle of 2007-2013, as well as progress in preparations for the Partnership Agreement and operative programmes that follow adoption of the joint (EP and EC, 2013) directives for the 2014-2020 budget period. This study does not cover political regionalism and is limited to the role of the regional institutional systems from the aspect of professional policy.

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**Keywords:** Regional policy, cohesion funds, institutional system, absorption, efficiency

## **Introduction**

The ten countries acceding to the European Union on 1 May 2004 joined right in the middle of a regional development cycle that was well

underway. So, the final two years of the 2000-2006 timeframe allowed the institutions of the new members to just get their feet wet in gauging the system and designing and implementing rules for monitoring the funds, despite earlier experience with pre-accession funding. The real test came with the first full seven-year period, from 2007 to 2013, which produced the first full absorption indices, and outcome and impact indicators. The two countries chosen for this study have similar histories, were much alike in their regional and economic features. There are also parallels regarding the orders of magnitude of the cohesion funds. The timeframes for learning to use the funds and the pre-accession funds were the same for both and their accession talks paralleled one another, giving them both a decade to get used to receiving and using the convergence monies.

### An overview of the 2007-2013 funding period

This chapter offers a concise illustration of the overall size of the funding granted to the Central and Eastern European members over the seven-year period. It points out funding similarities for the different countries by presenting the subsidies on a per capita population basis. Although Poland received the largest quantitative support country-wise (Table 1), when broken down into per capita population figures we find that it was just the opposite. Poland received the lowest per capita funding of all the EU members in the region. The opposite was true for Hungary. It had the second-largest volume of per capita convergence funding, with only Estonia receiving more. If we exclude the data on Romania and Bulgaria, which acceded later, we find that significant differences in disbursement ratios began to emerge in 2012, and this is what I would like to focus on, using current data and specific examples.

Basic CEE information on EU funds implementation 2007-2012												
	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	CEE total	CEE average
Available budget 2007-2013 (EUR billion)	6.7	26.31	3.4	24.9	4.5	6.8	67.2	23.5	11.5	4.1	180.9	-
Available budget 2007-2013 per capita (EUR)	911	2,504	2,541	2,503	2,227	2,253	1,743	1,102	2,128	1,995	-	2,002
Contracted grants 2007-2012 (EUR billion)	6.7	25.6	3.1	19.5	4.3	6.1	55.9	16.4	8.4	3.0	149.0	-
Contracting ratio (in %)	100%	90%	91%	78%	94%	91%	83%	70%	73%	72%	-	83%
Paid grants 2007-2012 (EUR billion)	2.3	16.2	2.0	10.0	2.6	4.0	32.7	2.8	4.8	2.0	79.4	-
Payment ratio (in %)	34%	57%	59%	40%	56%	59%	49%	12%	41%	50%	-	44%

Table 1: Source: KPMG: EU funds in Central and Eastern Europe – Progress Report 2007-2012

Table 2 compares the available development funds by type of intervention, and at this point the differing priorities of the two EU countries under investigation becomes apparent. If we specifically look at the volume of funding, we see that Poland used a far greater portion of its resources for human development and a lower one on infrastructure than Hungary. The biggest differences are in R&D and Infotech Communications (ITC) technology, where Poland spent five times more than Hungary. On the flip side, the Technical Assistance rubric, which includes the monies spent on usage management, was only twice as much in Poland as in Hungary despite Poland's far larger overall funding amount and greater population.

Available budget 2007-2013 (EUR billion)											
	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	CEE total
Infrastructure	5.1	24.0	2.0	20.6	3.2	4.3	40.0	12.8	8.4	1.5	122.0
Human Capital	1.1	4.3	0.8	2.3	0.6	0.9	10.2	3.4	0.9	0.7	25.2
R&D and ITC	0.2	1.8	0.6	0.8	0.6	1.4	13.3	1.4	2.1	1.7	24.0
Technical Assistance	0.3	1.1	0.1	1.1	0.1	0.2	2.1	0.2	0.1	0.1	5.3

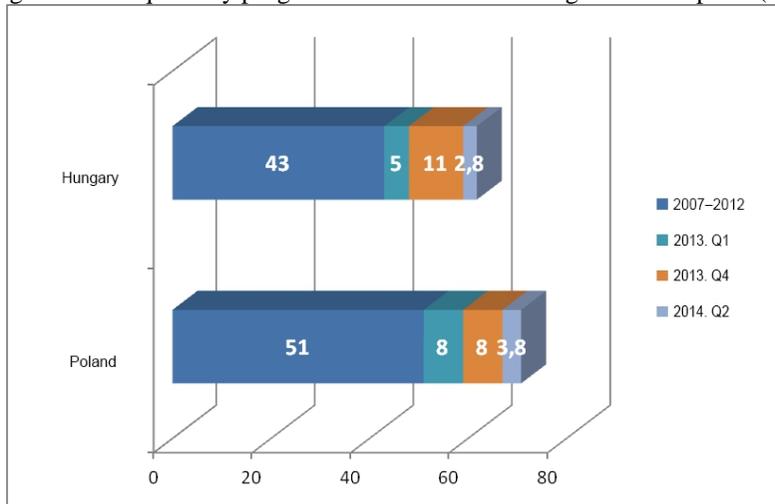
Table 2: Source: KPMG: EU funds in Central and Eastern Europe – Progress Report 2007-2012

Even the first table shows the difference in absorption rates between the two EU members we are focusing on with regard to the grants contracted and paid out up until 2012. We have the chance to show the picture in greater detail and extended to include the present by using the European Commission's quarterly reports (EC, 2014). The most recent Financial Programming and Budget Report issued by the EU Directorate-General for Budget, which includes the grants from the three funds – the European Regional Development Fund, the European Social Fund, and the Cohesion Fund – used and accounted for by Brussels (not including advances) was issued on 15 April. Actual spending by the member countries was somewhat higher than the amount appearing in these latest statistics (in some cases submissions for approval from Brussels had not yet been submitted or had been submitted but still awaited Brussels' verdict), but despite that a number of countries will need a near miracle to access the entire allotted amount by the end of next year, which is the n+2 deadline.

Excluding Croatia, (which acceded only recently and therefore had no comparative data), if we consider the list of the other 27 EU members in light of the April data, we will find Poland in 12th place with an absorption progression of 71 percent, and Hungary in 21st place with 62 percent. Of the countries acceding ten years ago, only the Baltic nations are ahead of Poland. Of course, the Baltic countries devoted a significant amount of the grants to SME development and venture capital funds, which statistically counts the

money as having already been spent (Balás, 2013). That is behind the high apparent access rate although they only will be able to give a final accounting of these monies to the EU after successful absorption. Another corrective factor relates to the countries that are entitled to Cohesion Funds in the first place. Of the countries ahead of Poland in absorption rates only Portugal and Greece receive these funds, which are intended for major infrastructural investments that require long preparatory and execution periods, and thus result in a prolonged period before the funds are accounted for. And then of course, ex post monitoring of Greece’s corruption issues could end up altering the list. But what the numbers actually boil down to is that Poland’s performance is outstanding when compared with all the countries that acceded in this century which includes the other countries in the Visegrád Group.

Figure 1: The quarterly progression of Polish and Hungarian absorption (%)

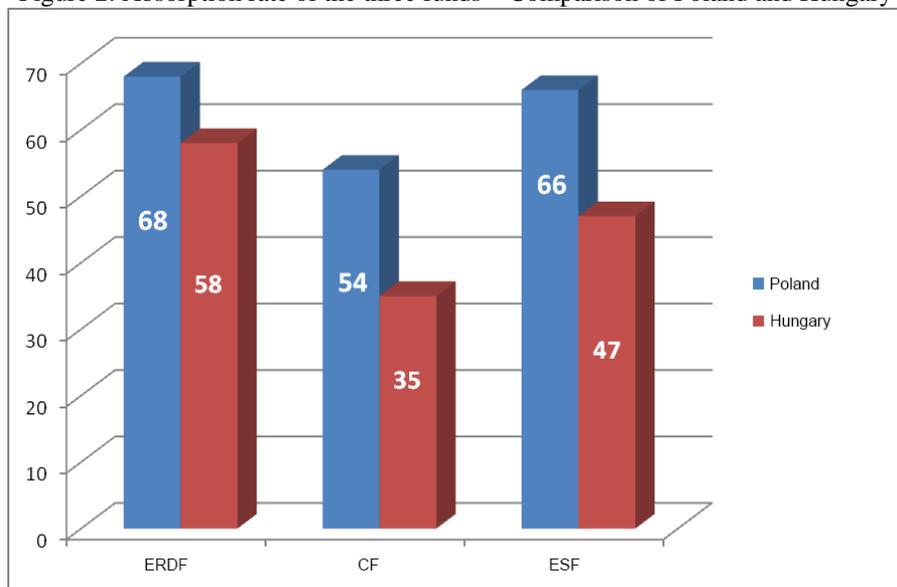


Source: Own work based on European Commission Regional and Urban Policy Finance and Budget Unit data

A look at the Figure illustrating semi-annual absorption progress (Figure 1) shows that Poland accessed nearly 10 percent more structural support than Hungary in 2012 and since then the gap has gotten wider still. When looking at the order under n+2 regulations, there are only four member countries with lower marks than Hungary, since Slovakia and Romania were granted an additional year in 2011 and 2012, to prevent them from losing funding.

There are additional extremes in access to the specific funds behind the averages (Figure 2). The statistics for the percentages accessed as of November 2013 show that Poland has not only done better overall, but also has had more balanced accounting rates per fund.

Figure 2: Absorption rate of the three funds – Comparison of Poland and Hungary



Source: Own work based on European Commission Regional and Urban Policy Finance and Budget Unit data

Hungary's access to 35 percent of the Cohesion Fund after a programme period of nearly seven years is particularly critical. The ostensible reason behind this is that Cohesion Funds are used for major projects which require long periods of preparation and institutional – generally EU – approval as well as other profession-specific permit processes and long periods of implementation. This was confirmed by a report issued by the State Audit Office of Hungary in 2012 (“Report on the evaluation of monitoring the bidding, designing and preparation of investment projects being financed as of 2007 with EU funds and implemented by government decision”), with other delays caused by prolonged public procurement procedures, problems with irregularities, and a lack of co-financing. The above, and an absence or alteration of specific strategies for the various sectors led to projects becoming bogged down or cancelled. The report cited above includes a plethora of shortcomings with the institutional support system which leads me to think it necessary to explore this factor by comparing the institutional systems of the two countries.

### **The role of the institutional system in the efficient use of grant monies – theoretical background**

One key to effectively accessing nominal supports is the system of institutions regulating it, operating on both member state and EU levels. Ederveen et al (2006) specifically state that structural funds are efficient in

countries where satisfactory systems of institutions are in place. Charron et al (2012) expanded on this in their study, by declaring that the level of national and regional governance and public administration is also an influential factor regarding efficient and successful access to the full amount of allotted cohesion funds. We can identify the institutional system responsible for fund use as a broader interpretation of Burnside's and Dollar's (2000) "supportive political environment" and of their approach suggesting that this is when cohesion policy works best. Professionals from the two examined countries under investigation agree with the above position. As Kozak (2006) wrote in the study about "European regional policy in Poland in the initial period after the accession:"

*"What is the only source of concern raised in relation to the preparation for the new planning period 2007–2013 (again, not backed by a sound strategy) is a reduction, once again, of the planning work on the management system to be 'improved' instead of creating a wholly new system, developed with a long term view and intended to attain the goals of Polish development policy implemented with the use of European funds, and not vice versa."*

Nyikos (2013), who has experience in Hungarian public administration, says that the effectiveness of regional policy is dependent on the efficiency with which the bodies controlling and managing it operate, and that general efficiency is dependent on the operation of the administration system. She adds the caveat that corruption and discriminatory phenomena can cause severe damage.

### **An overview of the institutional systems connected to regional development funds in both countries, from EU accession to today**

In Hungary, Act XXI of 1996 on regional development and territory regulation (hereinafter: Tftv.) underlined the importance of planning and defining the system of regional development institutions and the tools to be made available to them. The planning rested on a concept of regional development which was defined as the comprehensive and perspective development of an entire region. This was the foundation for a regional development strategy with regional territory development projects and medium term action plans in the superstructure (Kovács, I.P, 2003). In addition, the law provided a framework for starting up "learn as you go" regional development. The regional level was clearly designed at the urging of the European Union, primarily to coordinate the level with the use of EU funds (Phare followed by structural funds). At the same time, the parallels with the national and county structures were retained and the only clear distinctions between them regarding responsibilities and competencies were funding-related (Döbrönte-Vida, 2011). An ex post impact study conducted

within the framework of the Operative Program for Government Reform found that “prior to 1 January 2012 the large number of regional levels (micro-region, county, region, priority region, and national) resulted in unnecessary parallels and low levels of efficiency, weakened even further by parallel systems of institutions managing domestic and EU funds and regulating use of the grant monies.” (Magyary Programme 2012, p.16). The changes in the system of regional development institutions as of 1 January 2012 led to transferring regional development tasks to county governments and putting an end to the micro-regional and regional level development councils.

The loss of stability resulting from the above changes also means a loss of the professional knowledge, experience, and partnership-information of the various actors – regional/county/micro-regional development organizations and the bodies involved in managing the way the operative programmes are run – that had been accumulated through their work experience. Another loss is of the time during which it would become possible for the individual actors to get involved in planning the regional development. This had also occurred at the start of the 2007-2013 programming period when the micro-regional level, the equivalent of NUTS VI, was directly subordinated to the Regional Development Agency when shaping the regional operative programmes, which left out the county level completely. Serious shortcomings of this planning period included failure to take advantage of the knowledge and human resource capacities accumulated among the participants in county development projects, obtained through the placement and management of supports that had been provided by domestic budgets before the change. And we are now facing the hazard of this process being repeated, albeit the other way around, during the forthcoming seven year programme period. The version of the Tftv. amended in 2012 essentially defined two regional levels (county and national) to take the place of the five earlier ones, as it restored the regional breakdown that had been in effect before Hungary joined the EU. Restoration of county level authority, elimination of the micro-regions, and relegating the regions to secondary significance may trigger delays or shortcomings in the channelling of the past seven years of experience into the designing of the new system of objectives and/or methods of implementing the forthcoming operative programmes. This same problem surfaces when the authorities coordinating usage and managing strategies are chosen. The authorities were linked to the sectors from 2004 to 2006, then to a central organization (the National Development Agency) which ran from 2007 to 2013, and has now been shifted back to the ministries with an operative program for regional development to manage funding for 2014 to 2020. The change was a response to a real demand. Perger (2010) urged the establishment of a

comprehensive strategic management formation that ran powerful coordination and monitoring mechanisms while granting the sectoral and regional players increased latitude in planning and execution. The successive changes encompassing nearly a decade and a half are not promoting either current implementation or future planning operations. We will explore the latter in the next chapter.

Poland was later than Hungary in carrying out a public administration reform on the regional development plane, which in contrast with Hungary, was real instead of merely statistical. The outcome was that its regional policy became an autonomous sectoral policy. While the institutional system is an integral part of the sectoral management system it nevertheless operates in a decentralized manner when managing the decentralized operative programmes (Mezei, Schmidt, 2013). Poland was the only country to include NUTS 2 regions as autonomous units of public administration and local government ten years ago when joining the European Union. This divided authorities for regional development operations between local government and central government actors (Perger, 2010). It was also the only one of the Eastern and Central European countries to build its public administration reform and system of regional development institutions in a parallel and coherent manner. Poland does not have the regional development councils which are customary elsewhere in Central and Eastern Europe. To this day it lacks a regional development law, and it has not set up any autonomous institution to receive the EU funds. Instead, it has achieved real decentralization in which the regions have true decision-making rights, access to development funds, development programmes built up from the bottom up, and contracts for planning that guarantee the implementation of those programmes (Mezei, Schmidt, 2013. p.123). The elected local governments of the newly established voivodeships (provinces) – as opposed to the Hungarian regional development councils – are not merely players listed in support policies that are entitled to distribute certain minimal funds, for they are also the local social and economic development actors, thanks to true decentralization.

Poland is a good example of how regional development tasks can be shifted from top-down management of the local government sector to bottom-up mode. The two experts sum up their discourse by saying that all of this together heightens the legitimacy of the development policy and reinforces its integration, as evidenced by successful developments already completed and the rising absorption abilities of the regions.

### **Current issues in preparing the 2014-2020 programming cycle**

The differences in absorption in the 2007-2013 programme cycle as well as in the preparations for the 2014-2020 budget cycle might be the

outcome of differences in the institutional systems. As far as preparations are concerned, we need to point out that as of the end of March 2014, 12 member countries had submitted the documents required for the Partnership Agreements and operative programmes as called for in the preparatory phase of the 2014–2020 Multiannual Financial Framework to the European Commission. Poland was the first. On 10 January it submitted the Agreement to the EC as well as the documents for six operative programmes requiring use of Structural and Investment Funds. Hungary submitted its proposal for the Partnership Agreement two months later, but did not attach a draft for the operative programmes, which might have been because of parliamentary elections occurring in the interim. The processes of preparation are not competing against one other but are racing against the n+3 timeframe for using the monies. Nonetheless, the time of submission becomes important because if coordination talks are prolonged, they will cut into the time needed for project execution and the accounting process.

## **Conclusion**

This study has presented an overview of professional literature exploring the effects of the institutional systems on the use of regional development funds. It clearly supports the view that both project feasibility and implementation quality depend on the institutional setup which regulates them. Medium term impact studies are the primary sources of information on quality spending while the quarterly reports of the Directorate-General's Budget offer a great deal of interim information on the progress of absorption. The Polish example shows a truly – and not merely statistically evolved – satisfactory structure that is also sound as regards continuity, while as far as Hungary is concerned, continuous change – sometimes even within a programming cycle – rather than continuity is apparent in the institutional system of regional policy. This weakens the legitimacy, integration and transparency of development policy, which can be reflected in both the quality of spending and absorption ability. Possible outcomes are that some of the development funding remains unused or that it becomes necessary to prolong the deadline for accessing the monies similarly to Romania and Slovakia. In support of this, the economic downturn that began in 2008 slowed down the use of economic development funds, and European Council Directive [P7\_TA(2013)0455] Chapter 2 (Special Instruments), Article 11 (Flexibility Instrument) (EC, 2013) have already introduced n+3 accessibility.

The lesson in this case is the continued validity of the conclusions reached by Mezei and Schmidt in a study published last year, to the effect that it cannot hurt to maintain a certain degree of stability in the regulation of regional development and the system of institutions employed and that if

decentralization is real it is possible to exploit the opportunities inherent in bottom-up planning and initiatives. Stability also makes it possible to retain the knowledge accumulated within the various regional development institutions and participating organizations. And last, but not least, local and regional players need to be given the time to join the regional planning and procedures. I would like to conclude this study with Polish analyst Marek Kozak (2006) who adds the following thought and points the way towards additional research topics. “EU money is only a tool (...), it is not important how much money will be spent. What matters is what we will achieve with it.”

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