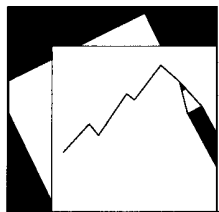


# Bulgaria's EU Funds Absorption: Maximizing the Potential!



# IMF Working Paper

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*Iana Paliova and Tonny Lybek*

**IMF Working Paper**

European Department

**Bulgaria's EU Funds Absorption: Maximizing the Potential!**

**Prepared by Iana Paliova and Tonny Lybek<sup>1</sup>**

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**Abstract**

This paper focuses on EU structural and cohesion funds assistance to Bulgaria during the 2007–13 program period. Initial weaknesses resulted in a low absorption rate, which was mitigated by increasing advance payments; applying electronic application and reporting procedures; simplifying and unifying tender processes; and strengthening the role of international financial institutions and banks in project preparation, evaluation and monitoring. The possible impact on growth and potential output is briefly discussed, while the risks of improper absorption are acknowledged. Valuable lessons have been learned, but it is recommended that additional steps be taken for the next program period 2014–20.

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## LIST OF ABBREVIATIONS

AA	Audit Authority, Audit of EU Funds Executive Agency of the MoF
AFCOS	Anti-Fraud Coordination Structure at the Ministry of Interior
CA	Certifying Authority, National Fund Directorate of the MoF
CAP	Common Agricultural Policy
CEE	Central and Eastern European Countries
CF	Cohesion Fund
CoM	Council of Ministers
DG	Directorate-General in the European Commission
DG REGIO	DG Regional Policy
DSGE	Dynamic Stochastic General Equilibrium Model
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
EP	European Parliament
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
FLAG	Fund for Local Authorities and Governments
GDP	Gross Domestic Product
GIMF	IMF's Global Integrated Monetary and Fiscal Model
GNI	Gross National Income
GNP	Gross National Product
JASMINE	Joint Action to Support Micro-Finance Institutions in Europe
JASPERS	Joint Assistance to Support Projects in European Regions
JEREMIE	Joint European Resources for Micro to Medium Enterprises
JESSICA	Joint European Support for Sustainable Investment in City Areas
IB	Intermediary Body
IFIs	International Financial Institutions
LOTHAR	Forecasting and monitoring system for EU SCFs absorption
MA	Managing Authority
MoF	Ministry of Finance in Bulgaria
MTO	Medium-term objective
NSRF	National Strategic Reference Framework
OP	Operational Program, there are seven in Bulgaria
PPP	Public-Private Partnership
SCFs	Structural and Cohesion Funds
TFP	Total factor productivity
UMIS	Unified Management Information System
WB	World Bank

## I. INTRODUCTION AND MAIN RECOMMENDATIONS

**This paper: (i) provides an overview of Bulgaria’s absorption of EU post-accession funds—particularly the Structural and Cohesion Funds (SCFs)—during the 2007–13 program period;<sup>2</sup> (ii) lists measures the authorities have taken to accelerate the initially very slow absorption; (iii) briefly discusses the potential impact on growth; and, (iv) identifies additional measures for the next program period 2014–20, which are listed in sub-section A.**

**Bulgaria, like other countries, was severely affected by the global financial crisis, which, in principle, could have been alleviated by faster absorption of EU funds.** De Long and Eichengreen (1991) have compared SCFs to the US Marshall Plan after the Second World War, which amounted to about 2½ percent of recipient country’s GNP at the time. The co-financing principle, size and management of the Marshall Plan are quite similar to the EU SCFs and were expected to achieve a similar significant positive impact on growth.<sup>3</sup> After the global financial crisis hit in September 2008, the European Commission (EC) launched the *Economic Recovery Plan*, which included accelerating social and cohesion spending (Monfort, 2012). Some argue that Poland—the only Central and Eastern European (CEE) country—avoided a recession during the recent global economic crisis in part due to timely absorption of SCFs (e.g., Rutkowski A, 2009; IMF 2013, page 4). It is thus useful to consider the lessons learned so far for the next program period 2014–20.

**SCFs are aimed at promoting growth in less prosperous areas by supporting public and private physical as well as human capital.**<sup>4</sup> First, SCFs will boost demand and can temporarily boost output. For a country like Bulgaria with a currency board and accordingly limited fiscal space, such grants could be a useful demand management tool to mitigate a recession.<sup>5</sup> In practice, however, this presumes that projects are prepared and can be released

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<sup>2</sup> *Post-accession EU funds* include operational programs (OPs) financed by the structural and cohesion funds (SCFs) and funds under the Common Agricultural Policy (CAP). The structural funds include the European Fund for Regional Development (EFRD), the European Social Fund (ESF), and since 1993 the Cohesion Fund (CF). The latter is aimed to support member states with a Gross National Income (GNI) per capita of less than 90 percent of the EC average. It is now subject to the same rules as the ESF and the ERDF. The EFRD, ESF and CF contribute to three objectives of cohesion policy: convergence, regional competitiveness and employment, as well as European territorial cooperation. The CAP includes two pillars: the first pillar comprises market intervention measures and direct payments to landowners and factory farmers, which are not discussed further in this paper; while the second pillar, which includes OPs for rural and fisheries sector development, are briefly covered.

<sup>3</sup> The Marshall Plan provided scarce international reserves to countries with shortages and currency restrictions with a view to alleviate these bottlenecks, while EU countries are characterized by free capital mobility. The impact might thus be relatively smaller.

<sup>4</sup> We focus on the impact of overall growth. It is outside the scope of this paper to discuss if the objective of SCFs to also promote convergence of poorer regions within countries is achieved (see e.g., Mohl and Hagen, 2011), or to in detail discuss if they complement, supplement or even undermine ordinary fiscal policy measures to achieve the socio-economic development objectives of the EU Treaty (see e.g., Tomova et al., 2013).

<sup>5</sup> Bulgaria is fully committed to its currency board arrangement (pegged to the euro) and the only exit strategy is ERM II membership and ultimately euro adoption at the current exchange rate. It means that any shock to the economy will have to be accommodated by the real sector, which must be flexible and dynamic. A continued prudent fiscal stance is thus necessary, which together with modest fiscal multipliers (Muir and Weber, 2013), limit the room for expansionary fiscal policy to alleviate shocks.

depending on the business cycle. Experience shows that this is not realistic. Secondly, only if SCFs make the economy more dynamic and add—in volume and/or quality—to the production factors, will they increase the production possibility frontier and have a more permanent impact on potential output. Finally, EU structural funds were intended to finance projects in addition to what would anyway be included in the budget—the “additionality principle”—and thus cause an additional fiscal burden. Reportedly, this principle has been interpreted “leniently” during the economic crisis.

**Most ex-ante studies assume that SCFs are spent effectively, efficiently and under favorable conditions.** In this case, growth in Bulgaria could increase by around 3 percentage points (Varga and Veld, 2010) or 3.6 percentage points (Gáková, 2009) per year in the medium term. The Bulgarian government’s SIBILA model estimates that accumulated GDP could increase by 9.3 percentage points during the 2007–15 period<sup>6</sup> or even higher in the longer run<sup>7</sup> compared to the baseline. Obviously, SCFs are an opportunity for visionary decision-makers, including easing initial implementation costs of structural reforms, to re-start the growth engine (Mitra and Pouvelle, 2012) and to reduce policy uncertainty currently plaguing many EU countries.

**There is an intense debate on the impact of SCFs on sustainable growth—similar to the debate on the effectiveness of development aid—basically if SCFs alleviating market failures outweigh the possible public policy failures.** Hervé and Holzmann (1998) offers a very helpful conceptual framework on how absorption of SCFs may have: (i) a direct adverse impact due to suboptimal management of the funds, for instance because of undue political interference, mismanagement, or even corruption; and (ii) an indirect adverse effect due to distortion of relative prices in case of supply constraints, for instance, by affecting private investments or creating temporary but unsustainable growth that blurs and delays overdue structural reforms. Nevertheless, there is consensus that SCFs can stimulate growth and potential output provided they are used effectively, efficiently, and on a timely basis. It thus seems that the quality of the spending—by looking at their sustainable impact using cost-benefit analysis (Florio, 2007) to prioritize projects based on social returns—would be a better success criterion than solely using the absorption level as the criterion. The Bulgarian Minister of Finance, Petar Chobanov, said in July 2013: “One of the key issues we should address in the allocation of the EU funds when formulating these major directions and priorities is how to increase the potential growth without which we cannot expect to achieve great results concerning the process of convergence.”<sup>8</sup>

<sup>6</sup> Bulgaria’s National Reform Program for 2013 at: <http://www.minfin.bg/en/page/573>. The estimates are based on the SIBILA model developed by Ganev et al. (2011) under EU funded project № 0018-ЦИО-3.2 “Development of model for SCF impact assessment” financed by OP Technical Assistance (<http://www.eufunds.bg/en/page/23>).

<sup>7</sup> An official document of the Bulgarian government notes: “Initial studies suggest that Cohesion Policy programs in Bulgaria may contribute substantially to an overall increase in gross domestic product (GDP), estimated at 15% by 2020” (ec.europa.eu/regional\_policy/sources/docgener/informat/.../bg\_en.pdf). This estimate apparently also includes SCFs during the 2014–20 program period.

<sup>8</sup> Statement made at a conference “EU Money and Bulgaria’s Prosperity—between Pessimism and Optimism” which was held at the European College of Economics and Management.



**At the time of EU membership on January 1, 2007, Bulgaria's administrative capacity was inadequate to quickly exploit the SCFs.** The administrative support from Brussels, which had been instrumental in the case of the pre-accession funds, was no longer available for a full-fledged EU member. Ironically, due to the overheating of the CEE economies until the global crisis hit in 2008, the poor absorption of SCFs was sometimes seen as a blessing (e.g., Rosenberg and Sierhej, 2007).

**The initial low Bulgarian absorption rate reflects numerous weaknesses.** At the central government level, compliance reports and control systems did not initially observe EC requirements, mainly due to inconsistency in structuring of the information management system. Cumbersome application procedures, administrative burdens, complicated procurement procedures, as well as vague processes with complicated guidance impeded project implementation. The procedures and responsibilities of the EU structural assistance administration were fragmented and staff had initially insufficient skills and resources. Operational Programs (OPs) and their priorities were not clearly promoted by the managing authorities (MA). Beneficiaries lacked capacity for timely preparation of the projects and consequently faced long verification and hence payment lags. There were frequent problems with tender procedures, expropriation procedures of land and real estate as well as environmental permissions and financial irregularities. In the second half of 2010, absorption accelerated, reflecting the high priority assigned by the government to improve absorption, including by appointing a special minister for EU funds.

**Other new EU member states faced similar challenges, but in contrast to Bulgaria, they had been able to gain experience during the previous program period (2004–07), and were thus better prepared for the 2007–13 period (Appendix I).** It is useful to distinguish between: (i) contract ratio (projects are approved and contracts signed); (ii) absorption ratio (advance payments plus verified payments disbursed); (iii) certification ratio (invoices have gone through the national verification and certification process and the certified expenditures sent to Brussels for approval and disbursement of funds); and (iv) final absorption, when projects have been certified by the EC. At end-2012, the 10 CEE EU countries had contracted 83 percent, but the contract ratio varied between 70 percent and 100 percent, while the absorption ratio ranged between 12 and 59 percent (KPMG, 2012, page 10). During 2007–12, the best performers regarding contracted funds were Bulgaria, the Czech Republic and Baltic countries, ranging between 91 and 100 percent—Bulgaria showing the highest contracting ratio. The Baltic countries and the Czech Republic were leaders regarding absorption with ratios between 56 and 59 percent.<sup>9</sup> Only Romania's SCFs absorption, which at end-2012 was 12 percent and 18 percent at end-June 2013<sup>10</sup>, did worse than Bulgaria's 34 percent, which at end-June 2013 had increased to 41 percent.

**During 2011–12, Bulgaria disbursed SCFs grants amounting to €1.6 billion, or almost triple the absorption during the 2007–10 period,<sup>11</sup> but the accelerated absorption also**

<sup>9</sup> In 2012, the average absorption ratio of CEE countries was 44 percent.

<sup>10</sup> <http://www.fonduri-ue.ro/>.

<sup>11</sup> For the 2007–10 period, SCFs disbursements amounted to €680.7 million or 10.2 percent of the available EU funding.

**poses some risks.** At end-2012, Bulgaria had made grant payments<sup>12</sup> of 34 percent (27 percent actually certified<sup>13</sup> and 100 percent contracted) of the available funds,<sup>14</sup> or about 4½ percent of 2012 GDP. A significant improvement in contracting took place during 2011–12. Nevertheless, more than €4 billion will have to be used, which remains a major political and administrative challenge, or they are lost. The recently accelerated absorption also entails risks. So far, better absorption is also due to larger advance payments to the beneficiary and faster verification process, respectively, faster interim payments. If irregularities were to be discovered by the Managing Authorities (MA), Certifying Authority or Audit Authority, the budget deficit will increase, since the EC will not be in a position to reimburse the spent amounts, and the MA, i.e. the government, has accepted the financing responsibility.

**In recent years, Bulgaria has taken additional steps toward improving its absorption of EU funds.** The Public Procurement Law was amended in early 2012 with a view to simplify and unify tender processes, introduce ex-ante control on the bidding documentation for all EU financed projects, and harmonize procurement forms. Furthermore, (i) electronic application and reporting through the EU funds information portal were introduced;<sup>15</sup> (ii) one central and 26 district information centers were established to help overcome gaps in application and implementation process, especially at the municipal level; (iii) the preparation phase of major infrastructure projects for EC approval were streamlined using expertise of international financial institutions (IFIs); (iv) partnership with all involved parties was fostered; (v) the role of banks in the financial evaluation and project monitoring was strengthened; and (vi) innovative financial instruments, including public-private partnerships (PPPs) are expected to leverage SCFs.

**The rest of this section lists key lessons for Bulgaria’s next program period,** while the rest of the paper is organized as follows: Section II and Appendix II provide an overview of the EU funds available for Bulgaria. Section III briefly discusses the impact on growth of better absorption of SCFs. Section IV provides an overview of the management of SCFs as well as measures already taking and measures that should be considered, while Section V summarizes the main conclusion.

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<sup>12</sup> *Payments* reported by the Bulgarian authorities on [www.eurofunds.bg](http://www.eurofunds.bg) include advances and verified expenditures by the managing authorities (MAs) under the respective operational programs (OPs). *Advance payments* (between 20 and 35 percent of the project’s budget) are paid by the MAs to the beneficiaries after the project contract has been approved. *Verified expenditures* are the eligible expenditures of the projects authorized by the MAs based on the invoices and other documentation provided by the beneficiaries for the project implementation.

<sup>13</sup> *Certified expenditures* are the expenditures authorized as eligible according to the EU requirements by the Ministry of Finance’s (MoF’s) National Fund Directorate as the certifying authority (CA). *Audited expenditures* are the certified expenditures, which the MoF Agency for Audit of EU funds, as the auditing authority (AA), has authorized as eligible expenditures. Non-eligible expenditures discovered by the CA or the AA in the control or audit process are reimbursed to the EU Budget through a special procedure for financial correction approved by the Council of Ministers (CoM).

<sup>14</sup> Excluding co-financing—the domestic contribution of each project varies from 15 percent to about 20 percent—VAT and land for infrastructure projected also have to be paid by the authorities. Assuming all projects have been approved and started before end-2013 and fully paid by end-2015.

<sup>15</sup> <http://www.eufunds.bg>.

## A. Main Recommendations for the 2014–20 Program Period

**In order to become better prepared for the next program period (2014–20)—particularly since the EU budget has been reduced<sup>16</sup>—Bulgaria would benefit from the following steps:**

- Finalize mid-term evaluations of all the OPs implemented during the 2007–13 program period by external evaluators with a view to draw lessons.<sup>17 18</sup> Specifically, they should:
  - develop a well-designed strategy for the government with clear and measurable objectives and priorities for the next program period, allowing implementation of integrated projects. A draft Partnership Agreement between Bulgaria and the EC on EU structural and investment funds was published in August 2013.
  - provide recommendations for adjusting each program, including changes to financial allocations and continuity of some projects, as well as improvement of the implementation process, management and control systems, the delivery mechanisms and design of the schemes.
  - bestow advice on more effective cost-benefit analysis, using more detailed success criteria, including social returns, than just the level of absorption.
- Make available EU structural assistance documents for discussion with pertinent stake-holders prior to 2014, with a view to ensure ownership and reduce the risk of time-consuming misunderstandings. In short, improve the cooperation between the managing authority and the ultimate beneficiaries.

<sup>16</sup> At the time of this paper, the EU allocations for the 2014–20 program period have not yet been finalized (the latest version of the Draft Agreement of Republic of Bulgaria outlining the Support from the European Structural and Investment Funds for the 2014–2020 period is from August 21, 2013 (<http://www.eufunds.bg/en/?q=Partnership+Framework+Agreement+2014-2020>)). It is expected to be finalized and published in January 2014. The OPs in the draft agreement are: Science and Education for Smart Growth (new); Good Governance; Innovations and Competitiveness; Regions in Growth; Human Resources Development, Environment; and Transport and Transport Infrastructure, Maritime and Fisheries, and Rural Development. The draft proposal, which is announced by the government, but is still not part of the draft agreement document, assumes a cut of SCFs by around €0.4 billion from €6.7 billion to €6.3 and of agricultural funds by €0.6 from €2.7 to €2.1 billion. The names of the Operational Programs for the next program period have changed in line with the new priorities. The indicative figures show a reduction in the current OPs to compensate the overall decrease in the EU funding for 2014–20 and the planned allocation of €363 million to the new OP Science and Education for Smart Growth.

<sup>17</sup> Mr. Tomislav Donchev, former Minister of EU Funds, has stated that external evaluators were appointed for an assessment of the current program period. Some mid-term evaluations of Bulgaria's OPs have been already prepared and publicly available at: <http://www.eufunds.bg/en/?q=external+evaluation>.

<sup>18</sup> David Hegarty (2003) stressed that the mid-term evaluation of the SCFs for Ireland, 1994–99, undertaken by the Economic and Social Research Institute, was “widely regarded—both in Ireland and in the EU—as an example of best practice in the evaluation of large, diverse programs”.

- Continue strengthening the coordination role by the Central Coordination Unit of the Council of Ministers,<sup>19</sup> with a view to ensure clear and strong horizontal guidance and monitoring. Note that the Bulgarian government has created a new ministry for investment with a view to prepare investment projects financed by EU funds during the 2014–20 program period.<sup>20</sup>
- Foster cooperation between the central government and municipalities, including through the already established EU funds information centers in order to provide general information to beneficiaries.<sup>21</sup>
- Strengthen the role of regional units of MAs in providing information, guidance and advice to the final beneficiaries.
- Adopt a law on EU funds assistance and management<sup>22</sup> together with respective secondary legislation with a view to specify: (i) documents of various OPs; (ii) authorities and beneficiaries involved in the process; (iii) procedures for application, use, disbursement of structural and cohesion assistance; (iv) procedures for supervision over the grant and use of structural and cohesion assistance; and (v) procedure for challenging the proceedings.
- Review procurement legislation to complement the 2012 amendments in order to assess major shortcomings and address them properly. Most of the irregularities during the current program period are due to the lack of administrative capacity of municipalities and sufficient accountability and transparency of the procurement process. Small and medium-sized companies have not had sufficient access to public projects, as the winners usually have been a few big companies.<sup>23</sup> Development of an

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<sup>19</sup> Bulgaria's Central Coordination Unit consists of three directorates: EU Funds Programming Directorate, EU Funds Monitoring Directorate and the Information Managing System Directorate. It supports the activities of the Council, Secretariat, the Deputy Prime Minister for EU funds and the annual meeting of the Monitoring Committee of the National Strategic Reference Framework (NSRF).

<sup>20</sup> In Poland, the regional development ministry is responsible for managing the EU funds and coordination of the activities; in the Baltic countries it is the ministry of finance. All countries' EU funds websites are available on: [http://www.interact-eu.net/links\\_national\\_structural\\_funds/172](http://www.interact-eu.net/links_national_structural_funds/172).

<sup>21</sup> According to the Constitution, the *municipality* is the only really autonomous sub-national government in the country. It is a legal entity, which has the right of ownership, adopts and executes an independent municipal budget in the interests of the local population. The current administrative-territorial structure of Bulgaria includes six planning regions, defined as level NUTS II, 28 administrative districts corresponding to level NUTS III, and 264 municipalities, which represent the level LAU 1. The 6 *planning regions* in Bulgaria are created simply as statistical units for allocation of the EU SCFs and do not perform administrative, nor financial functions. The 28 *districts* are sub-administrative units of the central government, which coordinate national and local interests, but do not have financial autonomy and do not provide public services to the population.

<sup>22</sup> For instance, in 2006 Estonia adopted a special law for the SCF assistance for the 2007–13 program period (<http://www.struktuurifondid.ee/oigusaktid/>). In Bulgaria, a draft law is not yet available for public discussion.

<sup>23</sup> One Bulgarian politician (Dimcho Mihalevski, quoted in Novinite on August 27, 2013) noted that: "In the first half of 2013, some 66.1 percent of the total worth of public procurement contracts has gone to 8

(continued)

e-public procurement procedure through online platform for bids available for participants would improve accountability and transparency of the procurement process, especially its assignment phase, and thus promote public confidence in public procurement.<sup>24</sup>

- Consider encouraging public-private partnerships (PPP) to apply for the use of SCFs, provided a fair risk-reward structure between the private and public sector.<sup>25</sup>
- If a bonus system is still considered an important motivating factor for quick project preparation and assessment, the bonuses at the managing authorities should only be paid after clearly defined steps have been successfully achieved.

## II. OVERVIEW OF EU FUNDS AVAILABLE FOR BULGARIA

**EU post-accession funds aim for income convergence and agricultural support with a view to developing the internal market (Box 1).** Before EU membership, candidate countries are eligible to pre-accession funds. Their purpose is to support institutional building, convergence with the *acquis communautaire*, and structural adjustment in agriculture and rural areas with a view to harmonize disparities between various regions.<sup>26</sup> At time of EU membership, the member becomes eligible for post-accession funds, which comprise: (i) structural and cohesion funds (SCFs), and (ii) agricultural funds. The SCFs, which are the largest—and are the focus of this paper—have three objectives: convergence (objective 1); competitiveness and employment (objective 2); and European territorial cooperation (objective 3). The 2007–13 program period included €347 billion<sup>27</sup>—more than a third of the EU budget—of which €179 billion to new member states joining in 2004 and 2007 (about 18 percent of the annual GDP of the region).<sup>28</sup>

**Bulgaria managed to absorb 72 percent and contracted 83 percent of available pre-accession funds, which may be a good illustration of what could happen to the post-**

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companies. ... In contrast, some 4000 small firms have accumulated 30.1 percent of the deals...” However, only large companies may be able to handle large infrastructure projects.

<sup>24</sup>In mid-2013, the Council of Ministers proposed new amendments to the public procurement act to: (i) allow subcontractors of state procurement contracts to receive money directly from the treasury; (ii) for projects over certain thresholds to mandate subcontractors be used for at a minimum 30 percent and maximum 70 percent of the contract; (iii) prevent the primary contractor to participate in future tenders if they have not settled their debt to subcontractors; (iv) provide tender documentation free of charge; (v) limit some of the tender requirements that reportedly have been used to exclude potential bidders; (vi) permit wider use of external consultants to assess the offers; and, finally (vii) strengthen transparency regarding recruiting and monitoring of the contracts.

<sup>25</sup> Bulgaria’s Law on Public-Private Partnership came into force from January 1, 2013. Funding is available under the EU’s JESSICA program for investment through public-private partnerships (see Box 5).

<sup>26</sup> PHARE, ISPA and SAPARD according to Financial Memoranda and Agreements: <http://www.minfin.bg/en/page/572>; [http://europa.eu/documentation/legislation/index\\_en.htm](http://europa.eu/documentation/legislation/index_en.htm)

<sup>27</sup> See: [http://ec.europa.eu/regional\\_policy/thefunds/funding/index\\_en.cfm](http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm).

<sup>28</sup> According to 2012 Eurostat data.

### Box 1. Background on Purpose of EU Post-Accession Funds

**In the late 1980s, the EU reformed the Community Budget and expanded regional aid with a view to accelerate economic development in lagging regions.** Article 158 of the Treaty on the European Union promotes harmonious development with a specific geographical dimension: “reducing disparities between the levels of development of the various regions and the backwardness of the least favored regions”. Since then, the main instrument has been: Structural Funds, specifically the European Fund for Regional Development (EFRD), the European Social Funds (ESF), the European Agricultural Guidance and Guarantee Fund (EAGGF, commonly known as FEOGA), and since 1993 the Cohesion Fund. Also since 1993, the common fisheries policy has been integrated in the rules governing the structural funds. The European Fisheries Fund was established in 2006 for conservation and sustainable exploration of fisheries resources under the Common Fisheries Policy. In 2007, the European Agricultural Guarantee Fund was established and replaced EAGGF. It finances direct payment to landowners and factory farmers and market measures to regulate agricultural markets, such as intervention and export refunds, and the European Agricultural Fund for Rural Development, which finances the rural development programs of member states.

**The SCFs underpin three objectives: convergence, regional competitiveness and employment, as well as the European territorial cooperation.** To overcome regional disparities complicating the successful realization of the Single Market, the European Commission allocated SCFs to seven less developed countries of the EU—frequently referred as “countries of Objective 1”. The beneficiaries were Spain, Greece, Ireland, Italy-Southern, Portugal, UK-Northern Ireland and East Germany. In 1989, the SCFs amounted to ECU 37.3 billion (at 1989 prices, or 2.1 percent of the average of the receiver countries’ GDP) and in 1992 ECU 208.7 billion (at 1994 prices, or about 2 percent of the GDP of the receiver countries). In 1997, the EU structural interventions promoted cohesion during the first period of the European Monetary Union (EMU) and the EU SCFs amounted to about 1.6 percent of the cohesion countries’ GDP on average (about 3 percent of GDP for Greece and Portugal). Agenda 2000 provisioned for pre-accession EU financing to CEE candidate countries.

**accession funds.** Bulgaria was allocated €2.6 billion (or about 12½ percent of 2007 GDP) pre-accession funds for the 2000–06 period. The deadline for absorption of SAPARD projects was end-2009, but it has been prolonged for PHARE projects to end- January 2012; for some ISPA projects<sup>29</sup> to end-2010; and only for Danube Bridge 2 to end-2011<sup>30</sup> (Table 1). The remaining pre-accession funds resources of €0.7 billion were lost.

**The 10 new EU member states have very different absorption rates of post-accession SCFs.** During 2007–12, the Baltic countries and the Czech Republic achieved the highest absorption ratio (Table 2). They were closely followed by Slovenia and Poland, and then by Slovakia and Hungary, which stayed slightly below the average level of 44 percent at end-2012. Despite the fact that Bulgaria increased significantly the pace of disbursements during 2010–12,<sup>31</sup> both Bulgaria and Romania need to take measures to catch up with the pace of the other CEE countries (Figures 1).<sup>32</sup> Older “new member states” (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia entered on May 1, 2004) are

<sup>29</sup> Available ISPA funding amounted to €1.5676 billion (€0.783 billion EU funding, €0.259 billion national co-financing, €0.286 billion from IFIs, and €0.239 billion in additional national and other financing).

<sup>30</sup> This was the contracting deadline after which the EU audit agency checked the project completion declaration by end-June 2013. Then the funds are declared to be reimbursed, but there is no deadline for the EC to finalize the procedure.

<sup>31</sup> The SCFs absorption rate of Bulgaria was only 2.6 percent at end-2009.

<sup>32</sup> For different country experiences, see Appendix I.

**Table 1: Bulgaria: Absorption of Pre-Accession Funds 1998–2006, as of July 2013**

Pre-Accession Funds	EU Funding (€ million)	Contracted EU Funding (€ million)	Absorbed EU funding (€ million)	Unused resources of EU Funding (€ million)	Payments as % of EU funding	Contracted EU Funding as % of EU Funding
PHARE	1,438.5	1,080.3	930.1	508.4	64.7	75.1
ISPA	783.2	744.0	706.8	76.4	90.3	95.0
SAPARD	443.1	376.7	285.8	157.3	64.5	85.0
<b>Total</b>	<b>2,664.8</b>	<b>2,201.1</b>	<b>1,922.7</b>	<b>742.1</b>	<b>72.2</b>	<b>82.6</b>

Source: Bulgarian Ministry of Finance ([www.minfin.bg](http://www.minfin.bg)).

**Table 2. CEE Countries: EU Structural and Cohesion Funds, end-2012**

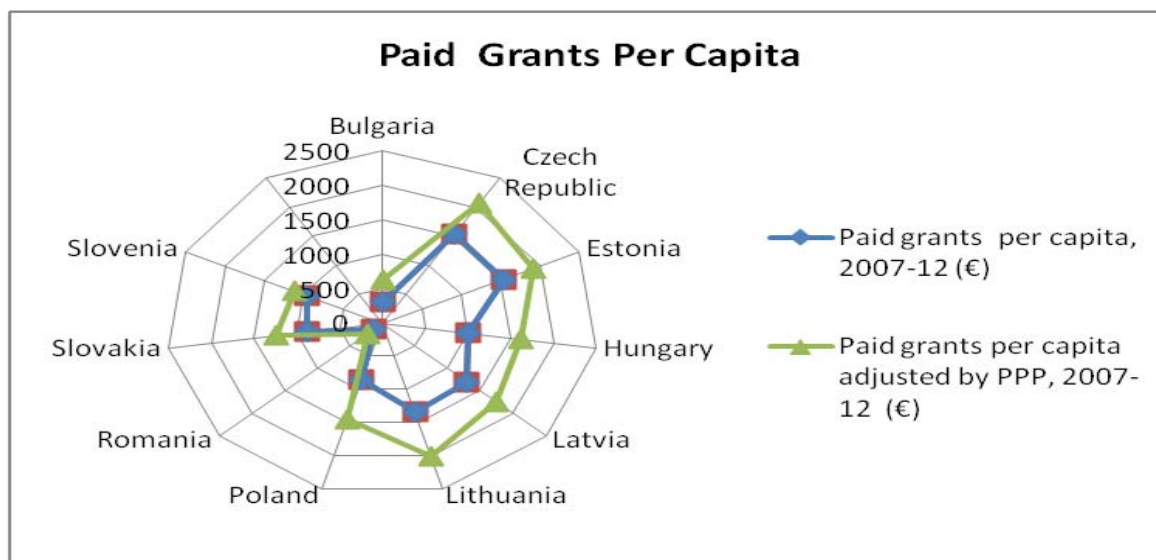
	Available SCFs 2007–13 (€ billion)	Available SCF 2007–13 (% of 2007 GDP)	Available SCFs 2007–13 (€ per capita)	Paid grants 2007–12 (€ per capita)	Contracted grants 2007–12, % of available budget	Paid grants 2007–12, % of available budget
Bulgaria	6.7	16.8	911	311	100	34
Czech Republic	26.3	17.2	2,504	1,543	90	57
Estonia	3.4	20.0	2,541	1,538	91	59
Hungary	24.9	25.5	2,503	1,000	78	40
Latvia	4.5	20.4	2,227	1,300	94	56
Lithuania	6.8	20.7	2,253	1,333	91	59
Poland	67.2	17.6	1,743	849	83	49
Romania	23.5	17.8	1,102	131	70	12
Slovakia	11.4	16.1	2,128	889	73	41
Slovenia	4.1	11.6	1,995	952	72	50
<b>Total</b>	<b>178.9</b>	<b>18.4</b>	<b>1991</b>	<b>782</b>	<b>83</b>	<b>44</b>

Source: Eurostat and KPMG 2013.



having much higher absorption than newer member states (Bulgaria and Romania entered on January 1, 2007). It is noteworthy that in contrast to other new member states, some Bulgarian OPs have been “over-contracted” to ensure full absorption in case some projects do not materialize, while any “overbooking” may be moved to the next program period. Nevertheless, the disbursement level varies significantly and can largely be attributed to EU members’ commitment and preparedness before the budget period began.

**Figure 1. CEE Countries: SCFs Grants Per Capita, 2007–13, at end 2012**



**The post-accession funds allocated to Bulgaria during the 2007–13 program period are significant.** They amount to €9.4 billion EU funding<sup>33</sup>—or on average about 3.7 percent of GDP per year during 2007–13—excluding about €2 billion in national co-financing—and should be compared to the about 1 percent of GDP in annual contribution to the EC.<sup>34</sup> The co-financing part is to ensure ownership and commitment to the projects by the national authorities and ranges from 15 percent for European Regional Development Fund (ERDF) and European Social Fund (ESF) to 20 percent for Cohesion Fund (CF). In addition to the “pure” co-financing, national authorities also have to finance the VAT—which will return to

<sup>33</sup> The amount does not include funds from the CAP first pillar (direct payment to landowners and factory farmers and market measures to regulate agricultural markets such as intervention and export refunds).

<sup>34</sup> In addition to the post-accession SCFs, Bulgaria also benefits from the other EU and EEA countries’ programs, which amount to about €0.76 billion (or about 1.8 percent of 2011 GDP). They include resources for Schengen Cash Flow Facility (€239.5 million, of which €128 million for Schengen), Cross-border and program (€262 million), Transitional Facility (€33 million), Financial Mechanism of European Economic Area (€21.5 million for 2004–09 and €78.6 million for 2009–14), Norwegian program (€20 million for 2004–09 and €48 billion for 2009–14) and Switzerland contribution to Bulgaria (CHF76 million). See: [www.eufunds.bg](http://www.eufunds.bg)



the budget—as well as about 90 percent of the costs for the appropriation of land for infrastructure projects. The projects have to be approved by 2013, but the last payments have to be made by 2015 (the N+2 rule). Table 3 and Figure 2 provide an overview of the various

**Table 3. Bulgaria: Status of Post-Accession Funds 2007–13, end-June 2013**

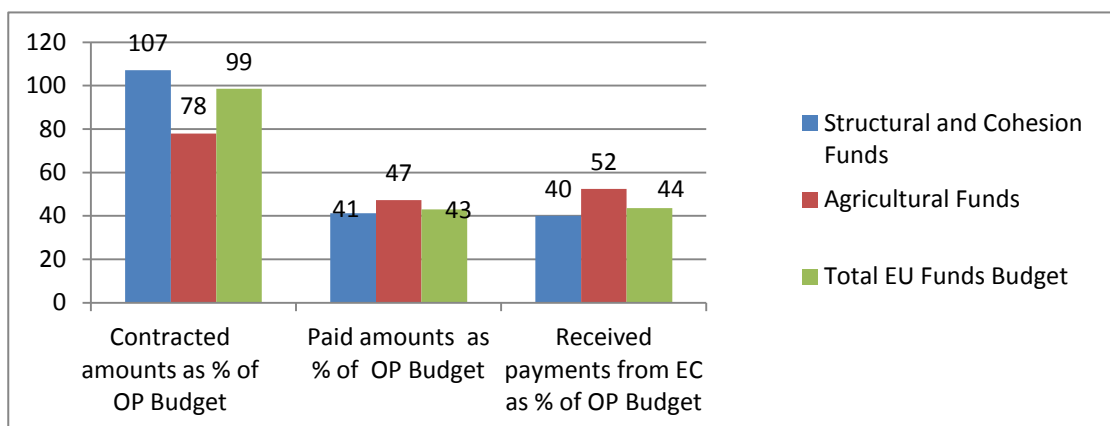
	OP EU Funded Budget 2007–13	Contracted amounts	Paid amounts	Received payments from EC
(Millions of euros)				
OP Transport	1,624.5	1,608.8	793.7	842.0
OP Environment	1,466.4	2,215.5	358.7	305.0
OP Regional Development	1,361.1	1,317.6	585.7	533.2
Competitiveness	987.9	835.7	477.8	495.6
OP Technical Assistance	48.3	46.6	19.9	15.8
OP Human Resources Development	1,031.8	984.0	453.3	410.0
OP Administrative Capacity	153.7	122.0	72.1	67.8
<b>TOTAL SCF</b>	<b>6,673.6</b>	<b>7,130.2</b>	<b>2,761.2</b>	<b>2,669.5</b>
OP Rural Development	2,679.2	2,019.1	1,239.9	1,378.4
OP Fisheries Sector Development	75.9	62.9	24.2	24.5
<b>TOTAL AGRICULTURAL FUNDS</b>	<b>2,755.1</b>	<b>2,082.0</b>	<b>1,264.1</b>	<b>1,402.9</b>
<b>Total EU funds</b>	<b>9,428.7</b>	<b>9,212.2</b>	<b>4,025.3</b>	<b>4,072.4</b>

Source: [www.eufunds.bg](http://www.eufunds.bg)

Note: Received payments from EC include advances during the first years of the program period.

1/ The amount does not include the CAP's first pillar funds.

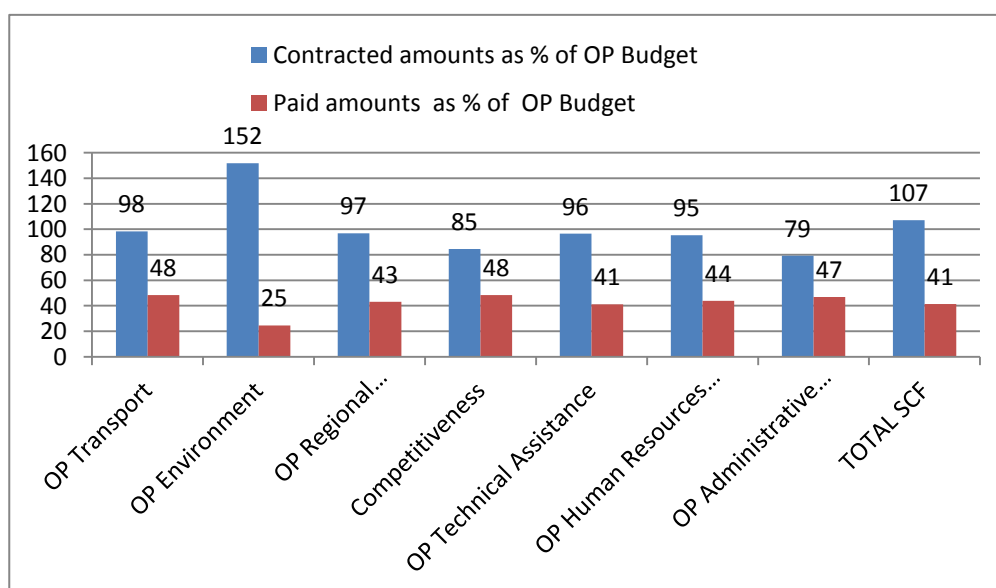
**Figure 2. Bulgaria: Post-Accession EU Funds, 2007–13, end-June 2013**



Source: [www.eufunds.bg](http://www.eufunds.bg)

Bulgarian OPs, including domestic contributions, while details about the various programs can be found in Appendix II. The National Strategic Reference Framework for structural and cohesion policies is financed through seven OPs: Administrative Capacity, Development of the Competitiveness of the Bulgarian Economy<sup>35</sup>, Environment, Human Resource Development, Transport, Regional Development and Technical Assistance (Figure 3).

**Figure 3. Bulgaria: SCFs Contracted and Paid, end-June 2013**

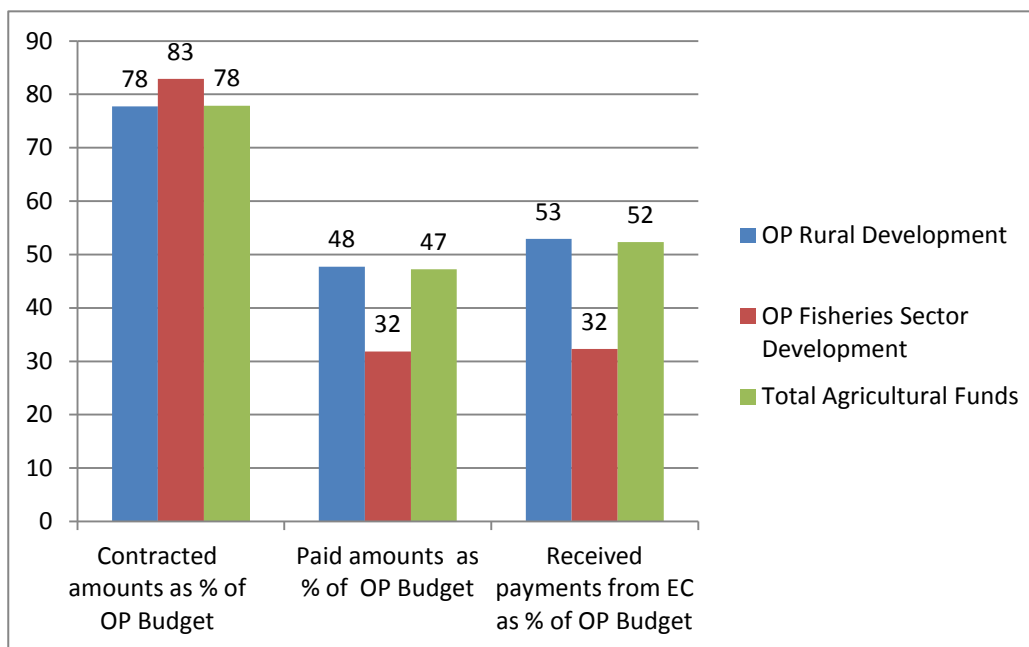


Source: Bulgaria's EU Structural Funds Single Information Web Portal [www.eufunds.bg](http://www.eufunds.bg).

**The agricultural EU funds available for rural development, agriculture and fisheries sectors, excluding co-financing, amount to €2.7 billion (or about 1.1 percent of average GDP during the 2007–13—or slightly more than the annual contribution).** The European Agricultural Fund for Rural Development<sup>36</sup>, Agricultural Guarantee Fund, and the European Fishery Fund finance agricultural policies through OP Rural development and OP Fisheries Sector Development (Figure 4)—see Appendix II for details.

<sup>35</sup> Herein after OP Competitiveness.

<sup>36</sup> The European Agricultural Fund for Rural Development implements the Common Agriculture Policy (CAP) and pays direct payments from Commission to farmers. It should ensure a fair standard of living in the farming community. In the first three years after the accession 2007–09, on average 20 percent of the Community rural support have been allocated to the measure “Complements to direct payments”.

**Figure 4. Bulgaria: Status of Post-Accession Agricultural Funds, end-June 2013**

Source: Bulgaria's EU Structural Funds Single Information Web Portal [www.eufunds.bg](http://www.eufunds.bg)

**Bulgaria needs to accelerate its absorption significantly to avoid losing funds from this program period.** By end-July 2013, Bulgaria had made payments of €3.3 billion of EU funds to various beneficiaries, or 41 percent of the total committed appropriations. This includes advance payments, expenditures verified by the EU and certified by the MoF. However, if the national or EU certifying and audit authorities discover any deficiencies, irregularities or frauds among the paid expenditures at a later stage, the absorption rate can be lowered. If Bulgaria does not use the available funds by 2015,<sup>37</sup> they may be lost, like some of the pre-accession funds. The EC has recently announced a risk for Bulgaria of losing of €276 million in EU funding in the case of four OPs by end-2013.

### III. THE GROWTH POTENTIAL OF EU FUNDS

**This section discusses different approaches to assess the impact on Bulgaria's output of using SCFs: various estimates suggest 1 to 3 percent compared to the baseline for the**

<sup>37</sup> The OPs have their initial allocation negotiated with the EC. Following the rule n+3, 2013 is the last possible year to declare amounts for reimbursement for 2010 and 2011 to the EC (for 2010 it is the n+3 rule and for 2011–13, it is the n+2 rule).

**2007–13 program period.** A single-country Keynesian model can be useful to assess the immediate impulse on demand of SCFs. It will, however, tend to exaggerate the positive impact on growth by not properly taking into account the financing implications, crowding out/output gap, as well as the type and quality of SCF spending. To assess the permanent impact on potential output, it may be more constructive to use a simple standard production function approach, while being conservative in the assumptions on the impact on capital accumulation, labor force and productivity given the practical difficulties in assessing the spillovers. To capture the dynamic elements—as demand reacts faster than supply can adjust, hence affecting relative prices—a general macro model, like the HERMIN model used by the EC or a multi-country dynamic stochastic general equilibrium (DSGE), is more appropriate.

**There is a contentious debate about SCF transfers' impact on growth—similar to the debate on capital inflows, development aid and even government intervention—given the fact that they account for over one third of the EU budget.** SCFs are financing infrastructure, new technologies, and hence alleviating bottlenecks, which should thus have a positive impact.<sup>38</sup> Furthermore, they could catalyst foreign direct investment (Katsaitis and Doulos, 2009). Hervé and Holzmann (1998) note that the standard models often ignore many of the possible adverse effects experienced in practice—perhaps because they complicate the models.<sup>39</sup> Hervé and Holzmann offer a helpful conceptual framework distinguishing between: (i) suboptimal use of SCFs in economies without supply constraints; and (ii) indirect adverse effects due to changing relative prices in economies with supply constraints, for instance if there is structural unemployment due to rigid labor markets.<sup>40</sup> They also note that the adverse effects tend to be positively correlated with the size of the available SCFs. Particularly toward the end of a program period, there is a risk of approving inferior projects to avoid losing SCFs, although they will not broaden the production possibility frontier,<sup>41</sup> but instead they could even create a future fiscal burden due to maintenance costs, etc. Boosting demand

<sup>38</sup> For instance, Tomova et al. (2013) find, based on an empirical study for 27 EU member states during 1980 to 2010, using low public debt in percent of GDP as a proxy for sound fiscal policy and low unemployment and current account deficit as indicators for sound macroeconomic policies that EU structural and investment funds (Abstract): "... are effective in helping Member States to enhance socio-economic development and this effectiveness is higher when combined with sound national fiscal and macroeconomic policies."

<sup>39</sup> Using an input-output table may better allow for sector differences, but it does not permit the use of behavioral relations and may not be that helpful. The Bulgarian Institute of National Statistics publishes input-output table with 65 sectors. The most current covers 2009: <http://www.nsi.bg/otrasalen.php?otr=42>.

<sup>40</sup> The former include: (a) weak administrative capacity; (b) rent-seeking behavior, including outright corruption; (c) rising consumption, adversely affecting investment in an inter-temporal context; (d) time-related problems adversely affecting private investment; (e) information disadvantage of the disbursing authority vis-à-vis the beneficiary (mainly for private sector); and (f) public choice issues (recipient countries may have other objectives than those formally stipulated by SCFs). The latter include: (a) Dutch disease (inflows contributing to overheating adversely affecting the tradable sector); (b) support to sectors that could have potential harmful consequences for long-term growth; (c) amplify market failures, for instance by improving transportation from areas with labor market rigidities and thus initially keeping regions in a poverty trap.

<sup>41</sup> In Bulgaria, the approval of an EU funded project of Payner Media's—a leading producer and distributor of "chalga" pop music and an owner of three music channels on cable television—for instance, "scandalized and polarized the country", according to BBC. (<http://www.bbc.co.uk/news/world-europe-21364650>). Payner Media then decided not use the SCFs. According to Yordan Mateev, editor-in-chief of Forbes Bulgaria, the Payner case was an opportunity to re-evaluate "the misguided philosophy of EU grants, which redistributes taxpayers' money to bureaucratically selected projects and priorities".

by SCFs could conceal structural inefficiencies that may blur the need for overdue structural reforms.<sup>42</sup> Finally, if irregularities are later identified, the beneficiary has to repay the funds, which could pose an additional fiscal challenge. These may be some of the reasons why Lolos (2001) note that ex ante studies tend to exaggerate the impact of SCFs compared to ex post studies.

**In short, the use of SCFs needs to be subject to clear priorities and prudent cost-benefit analysis with a view to increase the production possibility frontier by looking at the type and quality of spending rather than just to achieve a high absorption rate.<sup>43</sup>**

**Most ex ante simulations tend to assume: (i) well-functioning product and labor markets; (ii) effective and efficient absorption of SCFs; and (iii) domestic contribution in addition to the SCF grants—the so-called “additionality principle” for structural funds<sup>44</sup>—which, in our view tend to exaggerate their impact.** The additionality principle stipulates that EU structural funds may not replace national structural spending.<sup>45</sup> Kalaitzidaki and Kalyvitis (2006), for instance, note that absorption of structural funds could even be harmful, if they lead to higher distortive taxes. If this principle is not observed, the allotted amount could be reduced in the next program period. However, this has in practice been very difficult to verify and thus to enforce. Note that cohesion funds are not subject to the additionality principle. Ignoring the demand impact of the co-financing due to the additionality principle can also be interpreted as a way to take into account some of the adverse effects typically ignored.

**Given the reluctance to increase tax revenue to finance the co-payment, and the fact that co-financing often is compensated by cuts of other expenditures, we accordingly assume that the real opportunity cost is only the SCF grant. Our estimations on the growth impact of SCFs thus differ from most other studies by being more conservative.**

### **A. Demand Side Approach**

**Conceptually, the use of SCFs can be considered fiscal stimulus—particularly during periods when output is below potential. The grant element of SCFs reduces the financing burden compared to a standard fiscal stimulus.** It may be useful to first see how various EU funds so far have affected the budget of the general government, although we

<sup>42</sup> Agoloukous (1995) note that in Greece SCFs delayed stabilization policies with a view to maintain consumption.

<sup>43</sup> Florio (2007), among others, discusses the need to prudent cost-benefit analysis of the use of SCFs.

<sup>44</sup> Hervé and Holzmann (1998) argue that some studies exaggerate the positive impact on growth, since the additionality principle only applies to public investment and that there is no assurance that the public co-financing would not otherwise be collected and used.

<sup>45</sup> It was adopted in 1999 (Council Resolution No. 1260/00, Official Journal L. 161 of 26/06/1999. Article 15 of EC Regulation No 1083/2006), laying down the general provisions for the Structural Funds and retains the basic elements of Article 11 of the previous regulation (1260/99), as regards the principle of additionality. The underlying rationale states that EU Structural Funds may not replace the national or equivalent expenditure by a Member State. This principle is an important factor that causes Vincelette and Vassileva (2006)—who ignore the indirect multiplier effects on growth—to find significant negative direct fiscal effects of EU membership for Bulgaria (-1.6 percent of GDP during 2007–09).

mainly focus on SCFs. Table 4 shows the contribution to the EU and the receipts from the EU to the Bulgarian government. With the exception of 2007—the year of accession—Bulgaria has been a net recipient of EU funds. The transfers from the EU budget to Bulgaria, like the SCFs, are endogenous within the budget envelope, while agricultural subsidies are to a lesser extent under the control of the government. We thus focus on SCFs and ignore the agricultural funds, although some—particularly OP Rural Development—may be used to the buildup the capital stock and improve productivity. As previously mentioned, for some OPs up to 85 percent are grants from the EC, which in practice is less for the infrastructure projects, since VAT and the expropriation expenditures must be financed by the domestic budget. In the case of Bulgaria, the grant element of SCFs has increased from ½ percent of GDP to 2 percent of GDP during the 2007–12 program period and is expected to increase further.

**Table 4. Bulgaria: EU-Related Transfers to and from the General Government, 2007–12**

	2007	2008	2009	2010	2011	2012
	Percent of GDP					
Revenues (net)	38.2	38.0	35.3	32.7	32.4	34.2
o/w EU grants	1.8	1.5	1.8	2.1	1.8	2.8
o/w SCFs, incl. advances 1/	0.5	0.6	0.8	1.1	1.4	2.1
Expenditures (net)	34.9	35.2	36.2	36.7	34.4	34.6
o/w EU financed spending	0.8	0.7	1.4	2.5	2.1	3.2
o/w SCFs spending	...	0.1	0.4	0.9	1.5	2.2
o/w National co-financing	0.2	0.3	0.5	0.9	0.6	0.8
o/w Contribution to EU budget	1.0	1.0	1.1	0.9	1.0	1.0
Cash deficit	3.3	2.9	-0.9	-4.0	-2.0	-0.5
Adjusted revenue 2/	36.4	36.5	33.5	30.6	30.7	31.3
Adjusted expenditure 3/	33.2	33.4	33.7	33.2	31.3	30.4
Adjusted balance	3.2	3.1	-0.2	-2.7	-0.6	0.9
EU net transfers	-0.1	0.2	0.7	1.3	1.4	1.4

Source: Ministry of Finance and Fund staff estimates.

Note 1: Cash deficit (not ESA95).

1/ During 2007–09, Bulgaria received advances, which exceeded the actually spent amounts on SCFs. SCFs spending is thus higher toward the end of the program period.

2/ Adjusted revenue = Revenue - EU transfers (pre-accession, SCF, OPs of SF Agriculture).

3/ Adjusted expenditure = Expenditure - EU funded expenditure - Contribution to EU budget.

**Initially, a large share of SCFs was advances, which did not directly affect demand.**

During 2007–09, the SCF transfers were mainly advances and exceeded actual SCF spending and thus had no relation to demand. The advances were placed in the treasury’s account and are eligible only for EU funded projects. Since Bulgaria was running surpluses until the global crisis hit, they were included in the so-called fiscal reserve account. Toward the end of the spending period, the government will not be reimbursed by the EU, thus having an adverse spill-over financing effect on SCF spending. However, it will be mitigated by advance payments for the following program period. Accordingly, there is a difference in Table 4 between the revenue line for SCF grants, which includes advances, and the spending line, which better reflects actual demand caused by SCFs. There is another timing issue, since the economic impact on demand is when the money is spent rather than when reimbursed by Brussels, but this is difficult to capture and here ignored. Finally, SCFs allotted to the private sector will have a larger impact on growth than revealed by the budget of the government due to the private co-financing. However, most Bulgarian SCFs are allotted to the general government. **During the remaining of this program period, if SCFs are fully absorbed and ignoring the spill-over effects, demand could increase by around 3½ percent of GDP, but if Bulgaria only absorbs 72 percent—similar to pre-accession funds—demand would increase by around 2 percent of GDP.**

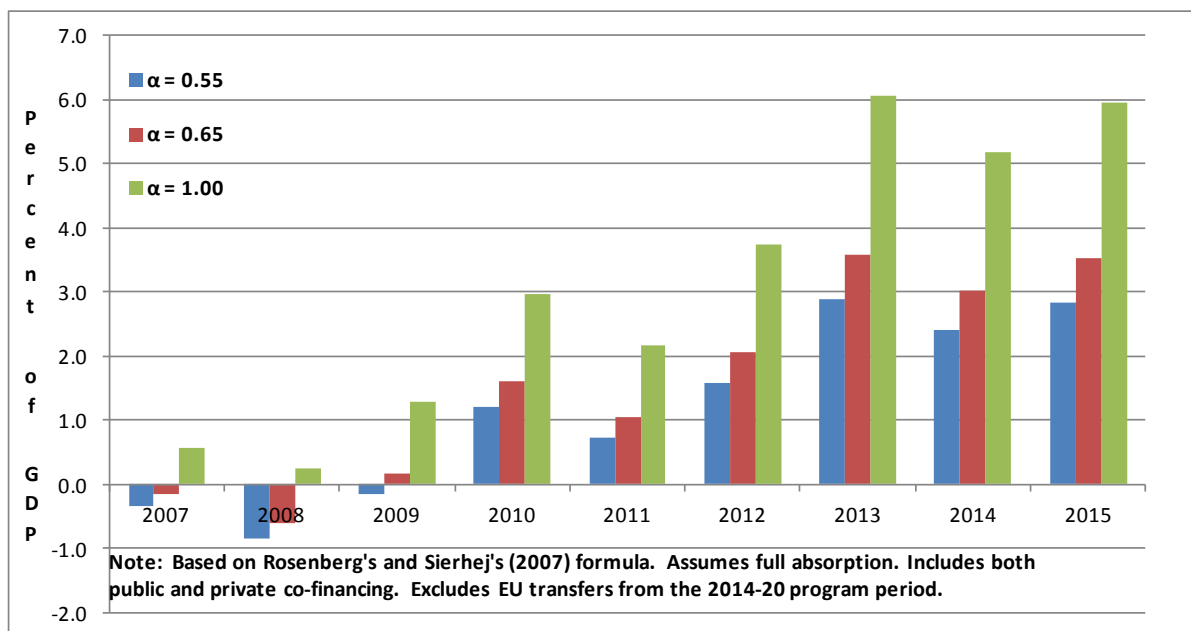
**Rosenberg and Sierhej (2007) use an easy-to-understand approach to assess the impact on demand (formula 1) of all EU related transfers, but make ad hoc assumptions on the crowding out effect.** However, the “crowding out factor” they use focuses on the substitution between EU funded projects and domestically funded projects. They argue that this factor— $\alpha$ —typically ranges between 0.55 and 0.65 in CEE countries, but following the additionality guidelines on structural funds, the crowding out could be even higher. During the first three years of Bulgaria’s EU membership, the overall demand effect was negative mainly due to the very low absorption of SCFs and the contribution to the EU budget. Absorption and thus demand picked-up and given the scheduled absorption, the impact on demand of all EU funds is projected to be around 3 percent of GDP (Figure 5). However, revising Rosenberg and Sierhej’s formula to focus on the impact on demand of only SCFs (formula 2) and ignoring the additionality principle as discussed above, Figure 6 shows impact on demand of, respectively scheduled absorption (about 3½ percent of GDP) and an absorption rate like the one of pre-accession funds (about 2 percent of GDP).

$$(1) \quad D = \alpha (Tr + NC) - C - A$$

$$(2) \quad D_{SCF} = \alpha (Tr_{SCF})$$

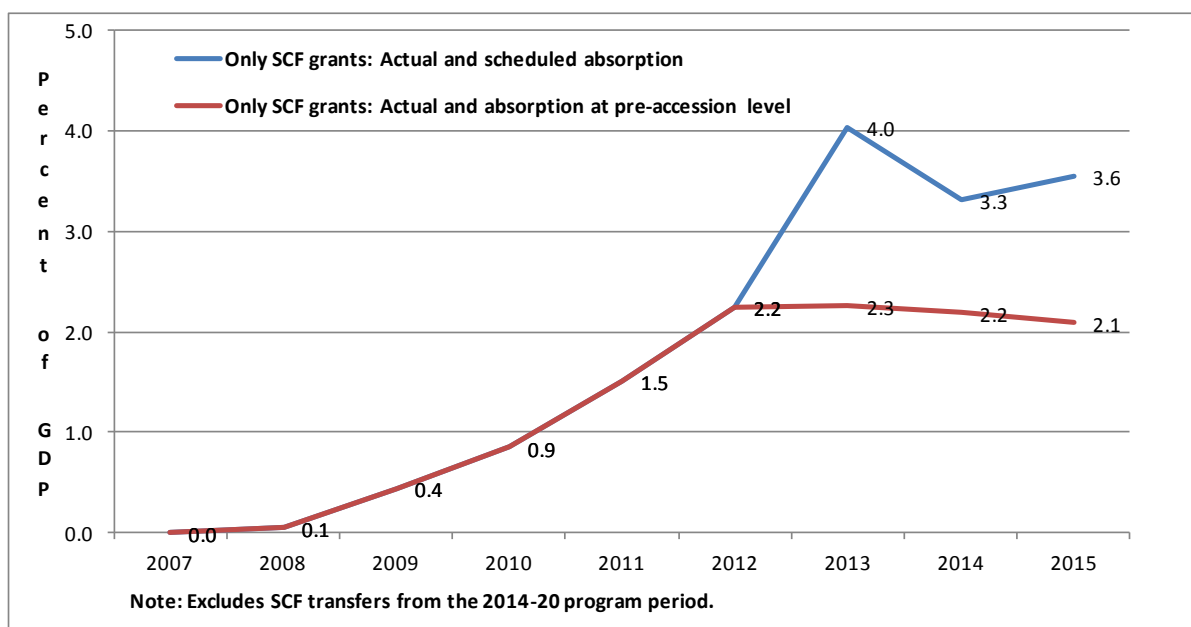
- where: D: Impact on demand by all EU funds, including  $D_{SCF}$  from SCFs  
 $\alpha$ : Substitution between EU funded and domestic spending;  $\alpha$  ranges [0;1]  
 ( $\alpha = 1$  if there is no substitution)  
 Tr: Transfers from the EU of which  $Tr_{SCF}$  is spent SCFs  
 A: Advances received, of which part are for SCFs  
 NC: National co-financing  
 C: Contributions to the EU budget

**Figure 5. Bulgaria: Estimated Demand Effect of Various EU Funds, 2007–15**



Source: Bulgarian Ministry of Finance and Fund staff estimates.

**Figure 6. Bulgaria: Estimated Impact on Demand of SCF Transfers, 2007–15**



Source: Bulgarian Ministry of Finance and Fund staff estimates.



## B. Production Function Approach

**It has become standard practice to use a production function approach to estimate potential output and it can easily be modified to illustrate the impact of SCFs.** Gasper and Leite (1996), as well as Hervé and Holzmann (1998), use a Cobb-Douglas function, setting the technology parameter equal to one, to find the new steady state value of output per capita due to capital transfers. Since most of the SCFs are primarily used for public investment, formula 3 provides a rough but useful rule of thumb of the potential impact of SCFs. Evidently, only to the extent that the transfers effectively increase the capital formation—which can be augmented to include technological improvements—will potential output increase. Obviously, if there are absorption weaknesses, it will hamper the effect, while positive externalities, like SCFs helping attracting foreign direct investment, will further increase potential output.

$$(3) \quad y^* = \left[ \frac{s+TR/Y}{n+\delta} \right]^{\frac{\alpha}{1-\alpha}}$$

$y^*$	steady-state value of output per capita
$s$	savings rate
$TR$	transfers fully used for capital accumulation
$Y$	nominal GDP
$n$	labor growth rate
$\delta$	depreciation rate
$\alpha$	share of capital

**Potential output can be estimated using a Cobb-Douglas production function with constant returns to scale technology.**<sup>46</sup> It is applied to decompose real GDP into capital, labor with the remaining difference being total factor productivity. Potential output can then be constructed by applying the production function on the three components smoothed by, for instance, a Hodrick-Prescott filter or, as in this case simply by taking a moving average around the observation of capital and labor, while we here are keeping the TFP factor unchanged. In case of Bulgaria, we assume that the output gap was closed in 2005.

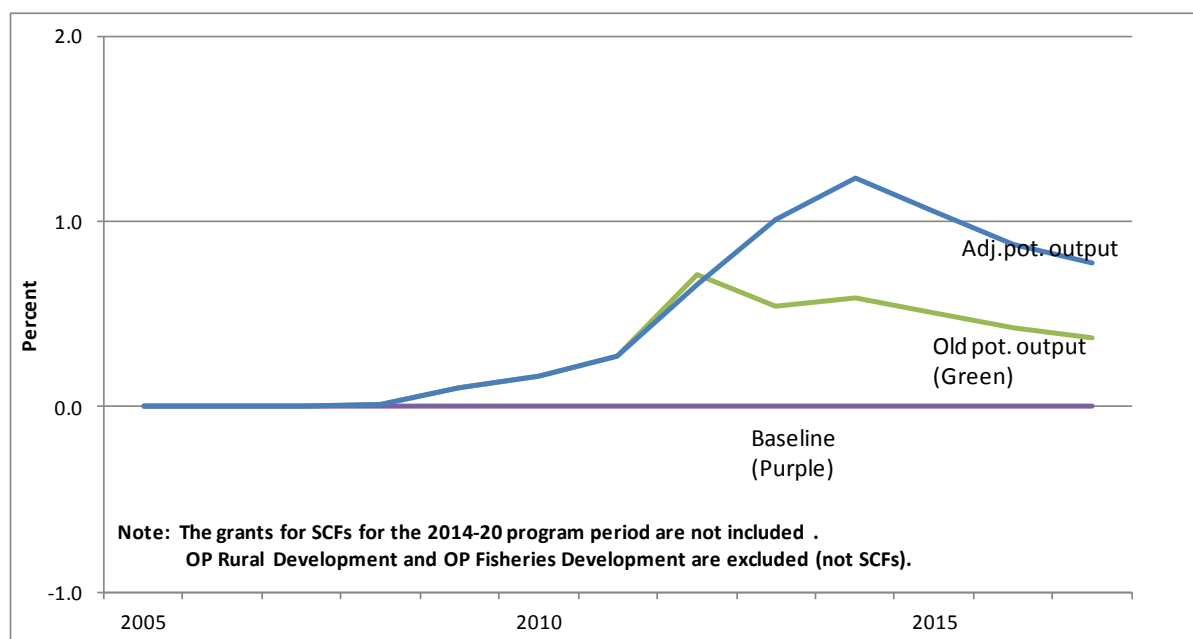
**Figure 7 illustrates the impact on potential output of SCFs absorption—with some conservative assumptions about capital formation—compared to a baseline without any absorption.** Since some SCFs already have been absorbed during 2007–12, we need to remove their impact in the baseline. We do this by mainly adjusting the capital stock applying some assumptions on how the various OPs contribute to capital formation, affect

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<sup>46</sup> Potential output cannot be observed and has to be estimated. See, for instance, Zhou (2010) for an application of the production function approach for Bulgaria and Epstein and Macchiarelli (2010) for Poland. It is a simplified version of the production function approach used by the European Commission for all EU countries (D'Auria, 2010). While the production function approach alleviates some of the problems of statistical methods, like the sensitivity of end-points using a Hodrick-Prescott filter, it also entails statistical problems, like measurement of the capital stock, and it does not capture structural shifts in a timely manner.

the labor force, and productivity, inspired by calibrations used by Ganey et al. (2011). As previously discussed, we only include the grant element of the SCFs, since the budget resources for co-financing and other domestically financed contributions are likely to be spent anyway. We also ignore the possible distortions of taxes needed for the co-financing. Furthermore, we only include OP transport, regional development, environment, and competitiveness. The remaining SCFs, like OP Human Resources, are relatively small—they mainly affect the labor force and productivity—and are thus ignored in this exercise. Then we apply similar coefficients but assuming, respectively, full absorption equally distributed during the remaining period (2013–15), while ignoring the grants of the 2014–20 program period, which have not yet been approved. Under these conservative assumptions, we estimate that SCFs increase annual potential output by 1 percentage point of GDP, but the effect will peter out in the medium-term as this additional capital formation depreciates unless new investments are made.

**Figure 7. Bulgaria: Impact of SCFs on Using a Production Function Approach, 2007–15**



Source: IMF staff calculations.

**The quality of the SCFs spending will have a noticeable impact on potential output.** For instance, there seems to be an urgent need to make the Bulgarian economy less energy intense, since it uses almost five times more energy to produce one unit of GDP than the EU-27 average.<sup>47</sup> Furthermore, as pointed out by the EC,<sup>48</sup> economic growth and competitiveness

<sup>47</sup> Although Bulgaria's energy intensity—the energy used to produce a unit of GDP—in 2011 had been reduced to 68 percent of its level in 2000, it is still almost five times (4.9) higher than the EU-27 average (Eurostat, 2013: [http://epp.eurostat.ec.europa.eu/portal/page/portal/energy/data/main\\_tables](http://epp.eurostat.ec.europa.eu/portal/page/portal/energy/data/main_tables)).

<sup>48</sup> European Commission, 2008, "Regions 2020: Demographic Challenges for European Regions".

will to a large extent depend on how Bulgaria deals with its challenges of a rapidly declining working-age population. The World Bank predicts that the labor force will have been exhausted as of 2015, and that productivity then will be the sole driver of GDP growth<sup>49</sup>—another reason to utilize the SCFs to boost the production possibility frontier rather than on consumption. The merit of this approach is the fact that it permits different assumptions about the impact on capital, labor and productivity of different OPs<sup>50</sup>.

### C. General Approach

**Comprehensive micro-based dynamic general equilibrium (DSGE) models can be a useful to capture various aspects of SCF absorption.** Allard et al. (2008) use the IMF's Global Integrated Monetary and Fiscal Model (GIMF)<sup>51</sup> to assess the impact for new member states as one group vis-à-vis EU-15 (the donor country). They distinguish between SCFs spending being: (i) transfers to households only having temporary impact on growth; (ii) private sector investment having some impact; while (iii) public sector investments have the largest permanent impact on output—about 3 percent higher than the baseline—mainly because the depreciation of private capital is assumed higher than on public capital. Varga and Veld (2010) use a similar approach, but estimate the impact of the SCFs during the 2007–13 program period for each EU country. For Bulgaria they find that output increases by almost 3 percent in the medium-term. Gáková et al (2009) use the EC's more traditional macro model HERMIN to simulate the impact of SCFs and find that with full absorption, as initially scheduled, GDP would increase by about 3.6 percent during the implementation period and the cumulative impact would in 2020 be around 1.9 percent of GDP.

**GIMF calibrated to Bulgaria suggests that absorption of SCFs could increase output by 2–3 percent in the medium-term.** Weber and Muir (2012) calibrated GIMF to Bulgaria, the EU, and the rest of the world (three country version). They find that Bulgaria has relatively low fiscal multipliers.<sup>52</sup> Given the model design, the largest multipliers is for public investments (0.5–0.7), but if used for government consumption, the impact on growth will peter out, and in case of lump sum transfers actually have a negative impact on growth, since the rational citizens will reduce their labor supply due to these transfers. They also consider the implications if SCFs result in a need for additional revenue. The short term impact of a tax increase obviously has a negative impact on growth (multipliers in the 0.3–0.6 range), but the least distortive taxes, like VAT, will only have a modest impact in the medium-term,

<sup>49</sup> World Bank Report No. 38570, 2007, *Accelerating Bulgaria's Convergence: The Challenge of Raising Productivity* and World Bank Report, 2013, *Mitigating the Economic Impact of an Aging Population: Options for Bulgaria* (<http://documents.worldbank.org/curated/en/2013/09/18262916/mitigating-economic-impact-aging-population-options-bulgaria>).

<sup>50</sup> Although we in this exercise do not take into account the impact on labor force and productivity of various OPs, their impact on potential growth could also be estimated.

<sup>51</sup> The GIMF model is described in Kumhof, Laxton, Muir, and Mursula (2010), and in Anderson et al. (2013).

<sup>52</sup> Batini et al. (2013) provide an overview of literature and empirical studies on how fiscal multipliers—defined as the one-year cumulative effect—are very country and time specific. Multipliers tend to be larger if: (i) the economy is less open to trade; (ii) automatic stabilizers are relatively small; (iii) monetary policy is accommodating and if close to the zero interest rate (liquidity trap); (iv) flexible exchange rate regime insulating the fiscal impulse; (v) relatively lower level of public debt; and (vi) if the economy is in a recession, hence having lower shadow price. Finally, spending multipliers tend to be larger than revenue multipliers.

while the more distortive ones, labor taxes and particularly corporate income taxes will have a permanent negative impact on labor supply and capital formation. Anyway, given the grant component of SFCs, there is a net positive impact in both the short- and medium-term, provided the SCFs are used for investment and used efficiently, while the co-financing part is financed by the least distortive taxes, like a VAT increase. Given the size of the SCFs and Muir's and Weber's (2013) multipliers, the impact on output in the medium-term is in the range of 1½ –3 percent.

**We have updated and re-calibrated the GIMF model. It confirms that the impact on output in the medium-term is in the range of 1½ –3 percent.** Figure 8 shows three scenarios compared to the baseline. The first scenario assumes absorption as initially scheduled, but only includes the grant element—i.e. ignoring the additionality principle. The second scenario also focuses on the SCF grant element, but assumes absorption at the same level as pre-accession funds (72 percent). Finally, scheduled absorption, including domestic co-financing, is assumed, but the domestic co-financing is financed by a VAT increase, which could boost growth by up to 3 percent, whereupon it will peter out. Nevertheless, given the caveats previously discussed, even boosting growth by 1 percent presumes that the SCFs are allocated efficiently and timely, while anecdotal evidence suggests that this is not always the case.

#### IV. BULGARIA'S MANAGEMENT OF POST-ACCESSION FUNDS

**EU funds implementation is shared between the EC and the member states in line with the subsidiarity principle.**<sup>53</sup> The priorities of the OPs are negotiated between the EC and each member state, but the implementation is managed by the individual member state. A special status is granted to projects with a total cost over €50 million in the area of transport, environment and energy, where a member state needs to conduct an ex-ante cost-benefit analysis and to receive approval by the EC before starting spending. However, an amendment was introduced in 2009 allowing member states to start spending even before the EC's approval.<sup>54</sup> At the EC, the pertinent institutions are, in case of cohesion and structural funds DG Regio and DG Employment,<sup>55</sup> and for rural and fisheries development program DG Agriculture. They have monitoring and advisory functions as well as a supervisory role on the national management and control systems. The DGs prepare ex-post evaluations of the cohesion policy and support countries in the strengthening of their administrative capacity in targeted areas: strategic planning, project management, audit and evaluation.<sup>56</sup>

<sup>53</sup> The subsidiarity principle is enshrined in various EC treaties and is intended to ensure that decisions are taken as closely as possible to the citizen. The EU should only take action in areas falling within its exclusive competence or if it can be done more effectively than at the national, regional, or local level. It also relates to the principle of proportionality, which stipulates that any action by the EU should not go beyond what is needed to achieve the objectives of the treaties. Marzinotto' (2011) recommendation that the EC should be empowered to directly manage certain EU funded projects with a view to accelerate absorption and reduce governance issues might be inconsistent with the subsidiarity principle.

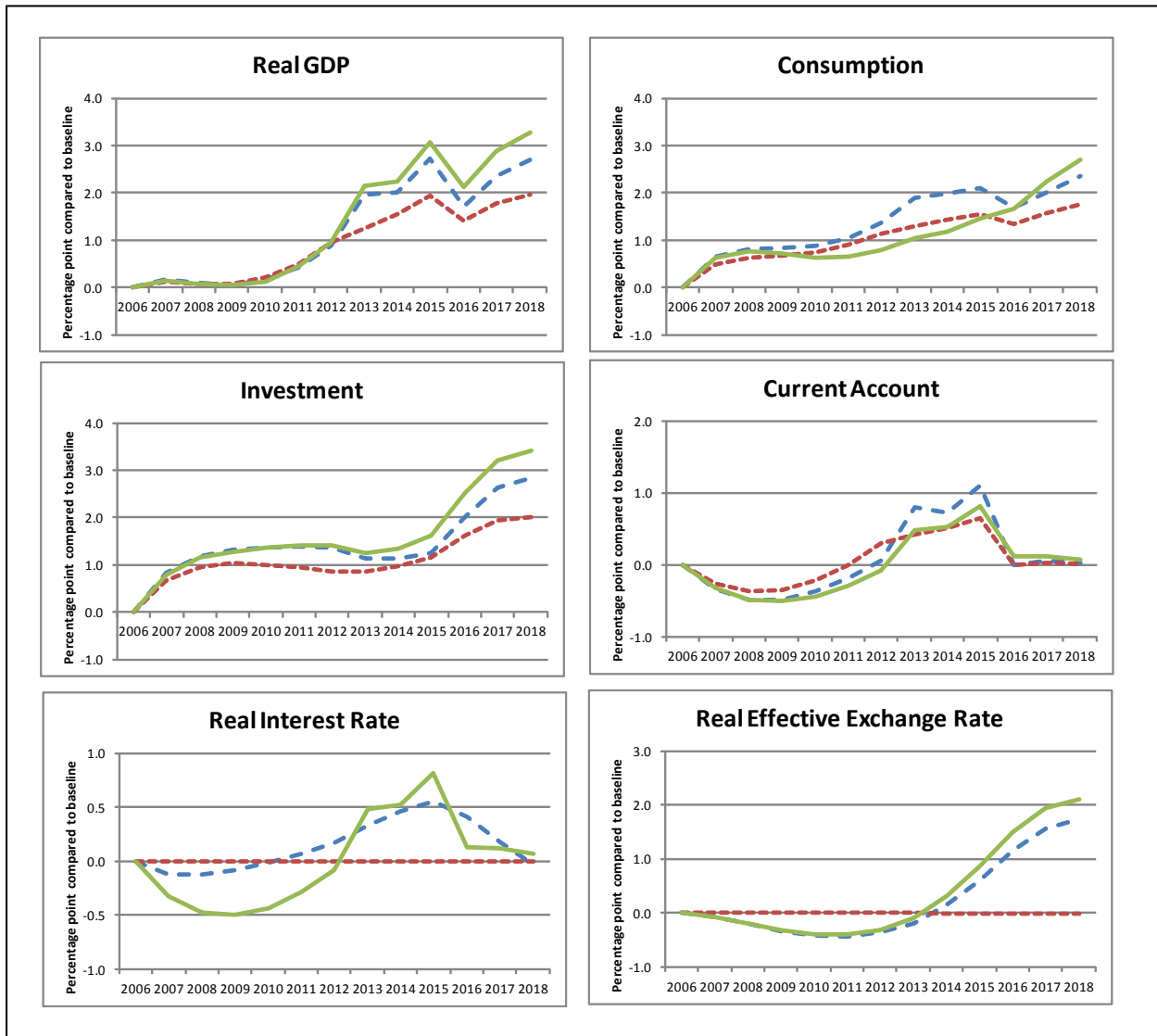
<sup>54</sup> Amendments to [Council Regulation \(EC\) No 1083/2006](http://www.eufunds.bg): <http://www.eufunds.bg>.

<sup>55</sup> DG Employment is in charge of OP Administrative Capacity and OP Human resources.

<sup>56</sup> 2010 Management Plan: [http://ec.europa.eu/dgs/regional\\_policy/documentation/document\\_en.htm](http://ec.europa.eu/dgs/regional_policy/documentation/document_en.htm).

**Figure 8. Bulgaria: Simulation of Impact on Macroeconomic Variables of SFC Grants**

- (Green): Absorption as initially scheduled, but only including the grant element.  
 - - - (Blue): Absorption at pre-accession level (72 percent), but only including the grant element.  
 ..... (Brown): Absorption as initially schedule, but including domestic co-financing, which is financed by a VAT increase.



Source: IMF staff calculations.

**The organization and the degree of decentralization of the national administration of SCFs vary among member states.** In some countries the responsibility is centralized in one ministry, including for the managing authority (MA). It could be a special ministry for EU funds or the ministry of finance (as in Estonia, Lithuania and Latvia). In other countries, a ministry (e.g., the regional development ministry in Poland, ministry of EU funds in Romania) or a special unit at the government (as in Bulgaria, Hungary, Slovenia) play mainly

a coordinating role with various line ministries in charge of the MAs. (Appendix I summarizes some experiences from different EU countries).

### A. Overview of SCF Procedures in Bulgaria

**Although the Bulgarian OPs comprise quite different types of funds with each their own institutions, it is useful to identify the generic structure.**<sup>57</sup> Box 2 illustrates the hierarchy of the various decision-making bodies as well as their respective roles in the EU funds' absorption process. The MA is the national authority in charge of developing the procedural guidelines on OP management and implementation, approving project proposals, overseeing the tender process, periodically overseeing the project implementation, monitoring the process and verifying the beneficiaries' payments. The MA is typically located in the relevant line ministry with one exception.<sup>58</sup>

**The procedures are different for the respective OPs, both at the national level<sup>59</sup> and at the EC level,<sup>60</sup> but some common procedures can be identified (Box 3).** The beneficiary prepares an application, which is submitted and assessed by the MA, perhaps assisted by the so-called intermediate body (IB). The application phase for big infrastructure projects can take years. It starts with the preparatory work of the beneficiary—usually a government unit—which develops the documentation and conducts a cost-benefit analysis that is submitted to the MA and then to the EC for approval.<sup>61</sup> The ministry for regional development is responsible for government infrastructure projects and prepares the documentation for their implementation. The municipalities concert the infrastructure project when the land is on their territory. Then, the CoM takes a decision on appropriation of land

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<sup>57</sup> Bulgaria's EU funds Strategy was initially defined and adopted by the CoM Decision № 312/2002), finalized in April 2006, and is now coordinated by the Council for EU Funds Management under the leadership of a special minister for EU funds. The main objectives of the strategy were to help complete the process of preparation of programming documents (National Strategic Reference Framework and OPs documents) and building institutional mechanisms for efficient use of SCFs. The specific objectives were to complete the legislative measures, strengthen the institutions and their administrative capacity as well as to ensure a transparent process.

<sup>58</sup> *Ministry of Agriculture* for both rural and fisheries development programs. *Ministry of Transport, Information Technologies and Communications*: OP Transport; *Ministry of Environment and Water*: OP Environment; *Ministry of Regional Development and Public Works*: OP Regional Development; *Ministry of Labor and Social Policy*: OP Human Resource Development; *Ministry of Economy, Energy and Tourism*: OP Competitiveness; *Ministry of Finance*: OP Administrative Capacity; *Council of Ministers*: OP Technical Assistance; *Agricultural Fund*: OP Rural Development and OP Fisheries Sector Development. The *Council of Ministers* for OP Technical Assistance.

<sup>59</sup> The *Procedural Guidelines on Management of the SCFs* in Bulgaria describe general management procedures for all of the OPs. Details on OP Transport are described in *Procedural Guidelines on Management and Implementation of OP Transport 2007-13* (in Bulgarian only). For details about other funds, see: <http://www.eufunds.bg/en/> (in Bulgarian only).

<sup>60</sup> The EU legislation for the SCFs is available on EU Funds Information Portal: <http://www.eufunds.bg/en/page/65>. For national legislation see: <http://www.eufunds.bg/en/page/119>.

<sup>61</sup> For large infrastructure projects over €50 million and environmental projects over €25 million, DG REGIO has to approve the cost effectiveness of the project.

## **Box 2. Organizational Units Involved in EU Post-Accession Funds Absorption**

The ***Council for EU Funds Management*** coordinates the activities with a view to ensure more effective absorption of EU Funds. The members comprise the ministers of foreign affairs; economy, energy and tourism; regional development; labor and social policy; transport, communications and information technologies; environmental issues and water; agriculture and food; the deputy minister of interior; of interior; while the deputy prime minister responsible for EU Funds is the chairman.

The ***deputy prime minister of EU Funds*** coordinates the activities of the EU funds structures with the Council of Ministers and other ministries to ensure more effective management and absorption. The deputy prime minister monitors that priorities are observed and targets achieved.

The ***Secretariat of the Council*** supports the activities and reports to the Council of Ministers. It consists of three directors of each of the directorates and two experts.

The ***Monitoring Committee of the National Strategic Reference Framework*** meets once per year and includes the deputy prime minister of EU Funds, the chairmen of the monitoring committees of the OPs and the directors of the Central Coordination Unit. The deputy prime minister of EU Funds is the chairman of this Committee and oversees the implementation of the National Strategic Reference Framework (NSRF).

The ***Central Coordination Unit*** consists of the Council of Ministers' directorates: EU Funds Programming Directorate, EU Funds Monitoring Directorate and the Information Managing System Directorate. It supports the activities of the Council, Secretariat the deputy prime minister for EU Funds and the annual meeting of the Monitoring Committee of the NSRF.

The ***Monitoring Committee of the OP*** is set up in agreement with the managing authority (MA) within the respective ministry. The Committee draws up its rules of procedure within the institutional, legal and financial framework of Bulgaria and adopts them in agreement with the MA (Art. 63 of the EC Regulation 1083/2006). The Monitoring Committee for an operational program consists of chairman, members and observers. During meetings, the chairman and the members have the right to vote, while the observers have only advisory functions. The chairman is the deputy minister responsible for the MA.

The ***Managing Authority*** (MA) is responsible for managing and implementing each of the operational programs (OPs) efficiently, effectively and correctly in accordance with sound financial management procedures (Art. 60 of EC Regulation 1083/2006). It approves the application, monitors the implementation and does spot checks as part of the verification process.

The ***Intermediate Body*** (IB) is a body of public or private representatives, who acts under the responsibility of a managing or certifying authority and who carries out duties on behalf of such an authority vis-à-vis beneficiaries (according to Art. 2 (6) of EC Regulation 1083/2006). The IB ensures the implementation of one or more interventions in accordance with the provisions of an agreement concluded between the MA and that body. It must normally be established or represented in the region or regions covered by the operational program at the moment of its designation.

The ***Agency for Public Procurement*** executes ex-ante control of the bidding documentation of the projects with EU financing. The aim is to avoid mistakes that lead to financial corrections and reimbursement to the EU budget, conflicts of interest and the possibility to prepare bidding documentation for certain candidates.



### Box 2 continued: Organizational Units Involved in EU Post-Accession Funds Absorption

The **Certifying Authority** (CA) is the National Fund Directorate (NFD) in the MoF. It performs checks of the reports on certification and statements of eligible expenditures, spot checks as part of the function on certification of expenditures under SCFs and in compliance with Art. 61 of Council Regulation (EC) No. 1083/2006, re-submits to the EC certificates under the OPs (see: <http://www.minfin.bg/en/page/55>).

The **Audit Authority** (AA) is the Audit of EU Funds Executive Agency at the MoF. Its main functions are to perform audits of operations and system audits in compliance with internationally accepted auditing standards, and on the basis of their results to provide to EC annual control report and annual audit opinion for each OP on legality and irregularities of expenditure declared to EC. The agency is responsible for other programs (such as EU cross-border programs, European Return Fund, External Borders Fund, etc.), as well as for EU pre-accession funds ISPA and SAPARD (see: <http://www.aeuf.minfin.bg/bg/page/12/>).

The **AFCOS of the Ministry of Interior** is the Bulgarian specialized unit for fraud reporting. In the unlikely event of fraud, anybody can, at various stages, report to the AFCOS of the Ministry of Interior or OLAF, the EC fraud investigation unit (<http://ec.europa.eu/dgs/olaf/mission/>). If fraud is identified, the case is given to the prosecutor. If they confirm the concerns, the EU funds will be paid back by the beneficiary or the managing authority, if the problems relates to the latter.

The **National Audit Office** is responsible for auditing and certification of all public resources and spending, including projects financed by EU funds and thus provides a final check of the Parliament (see: <http://www.bulnao.government.bg>). Its main functions are to prepare methodological guidelines and assessment reports on the management and control systems of the OPs, (it also certifies SAPARD expenditures), and functions as an auditing authority of the OPs and other EU funded programs (see: <http://www.aeuf.minfin.bg/bg/page/12/>).

The **Beneficiary** is the client benefiting from the funds, which can be the central government, local government or public and private companies (legal or physical persons). They prepare the proposal, sometimes with the assistance of consultants, and are responsible for the implantation of the projects according to EU and national requirements. The beneficiaries have to identify the co-financing and also pay for the VAT and 90 percent of the cost for land appropriation (10 percent may be eligible expenditures financed by the SCFs).

and payment of compensations to the owners,<sup>62</sup> while the beneficiaries provide the necessary co-financing and VAT funds for the respective budget year.

**After the approval of the application documentation, a tender is organized, which typically takes five to six months.** As previously noted, the 2009 amendments of the EC Council Regulation No 1083/2006 for structural funds allow tenders for big infrastructure projects to be organized even before the EC approval, which has speeded up the process. Tender results can be contested within the legal deadlines, which now are up to three to four months. These deadlines were introduced in 2010 after problems with frivolous challenges, as discussed below. In some cases, however, the EC requires additional information to prove the tender's financial results and only after the EC's approval can the implementation begin.

<sup>62</sup> 10 percent of the appropriation cost for land is eligible expenditure paid by the OP.



### Box 3. Concepts of Operational Procedures of EU Post-Accession Funds

An **application** can be submitted by any beneficiary eligible according to the respective OP guide. This is typically the central government, local government, an NGO or a private company (legal or physical person). There are strict requirements for the application. Many applications benefit from consultants, although their quality varies significantly. There is not a recognized short list of qualified consultants and it is difficult to hold them accountable. For instance, some consultants have not fully appreciated the different procedures for different OPs thus causing problems for their client.

The **approval** of the project is done by the MA, sometimes with the assistance of the IB. Certain criteria have to be observed, including prudent documentation. For instance, where beneficiaries are from the private sector, a letter of comfort from a bank is required to ensure the project is bankable. For large infrastructure projects over €50 million and environmental projects over €25 million, DG REGIO has to approve the cost effectiveness of the project to be eligible.

The **tender process** has to follow the national procurement law, which must be consistent with EU *acquis communautaire*. The Agency for Public Procurement executes ex-ante control of the bidding documentation of the big projects with EU financing, but according to the proposed amendments of the Public Procurement Law this procedure will be applied for all EU funded projects, since most of the problems are typically related to the tender. For the smaller projects up to Levs 110 000, the public beneficiaries apply the Ordinance for Public Procurement of Small Orders. Tenders can be contested in 10 days, but in Bulgaria such complaints are assessed by the Protection Competition Commission within two months, whereupon they can be brought to a court in 14 days, which makes a decision within one month, so the process should, in principle, only take about four months.

The **monitoring** of the project preparation and implementation is done by the MA, which may delegate this to an IB, but the MA is ultimately responsible. It is encouraged to make spot checks in addition to off-site monitoring. The OP Monitoring Committee is overseeing that the MA is following the regulation and procedures during this process.

The **advance payments** are made by the MA after the contract has been approved. These payments range from 10 to 20 or 35 percent of the project's amount depending on the OP's and beneficiaries' request.

The **verification** is done by the MA during the project implementation. The MA goes through the documents provided by the beneficiaries on a monthly basis, perform on-the-spot checks and decide whether expenditures are eligible and regular. On this basis, the MA pays the respective verified amounts to the beneficiaries. The functions of MA are described in Council Regulation (EC) No 1083/2006.

The **certification** is a process of control of verified expenditure. As a result the expenditure certified is declared to EC from the Member State in order to be reimbursed by the respective EU fund. The procedure is done by the National Fund Directorate (NFD), which executes the functions of Certifying Authority as described in Art. 61 of Council Regulation (EC) No.1083/2006.

The **Audit Authority functions** as required in Art. 62 of Council Regulation (EC) No 1083/2006, are entrusted to the Agency for Audit of EU Funds at the MoF. This agency provides the EC with an annual audit opinion regarding the legality and regularity of expenditure certified and declared to the EC.

**The MA is responsible for registering irregularities** in case such are discovered and to reduce the corresponding amounts from the expenditure reimbursed to the beneficiaries. If the Certifying Authority and Audit Authority find such cases, they are authorized to propose also reduction of the reimbursement of EU funds. In case of indication of fraud and criminal actions, the respective authority passes the case to the prosecutor.

**EU funded expenditures are subject of check by EU authorities** (EC and European Court of Auditors), **as well as at national authorities** (for example the National Audit Office, which reports to the Parliament).

**After the contract has been approved, the MA provides advance payments to the beneficiaries.** During the implementation of the project, beneficiaries receive interim payments based on the verified expenditures by the MA. The payment limits' procedure was streamlined in 2010, allowing the MAs to use the current resources of OPs and thus to speed up the verification process and payments to beneficiaries. In the certification/auditing process some of the payments made by the MAs to beneficiaries may be deemed non-eligible expenditures, and the respective amounts will have to be reimbursed to the EU Budget. If there are systemic problems, it could potentially become a major challenge for the national budget deficit.

## **B. Identified Shortcomings and Measures**

**The slow absorption since 2007 has made the Bulgarian authorities take several measures.** At the beginning of the program implementation, financial management and control systems of the OPs were not operating effectively. To support the government's efforts, the EC established an intensive dialogue with the Bulgarian authorities and recommended a number of corrective actions including an analysis of systematic weaknesses in administration and control of OPs implementation, the application of corrective actions and the establishment of stricter supervision. Conflicts of interest, weak financial supervision and administrative capacity, as well as legislative flaws were identified as main shortcomings. Actions have typically been taken to address shortcomings identified in the monitoring reports of the EC<sup>63</sup>, annual reports on EU absorption presented to the Bulgarian Parliament,<sup>64</sup> and analyses of various NGOs.<sup>65</sup> This section summarizes the shortcomings and key measures taken, while Box 4 details the measures taken by the 2009–13 government.

### **Conflicts of Interest**

**In 2008, procedural and legislative changes were undertaken to effectively deal with conflicts of interest.** Bulgaria adopted a Law on Prevention and Detecting of Conflicts of Interest<sup>66</sup> to improve monitoring and control over the management of funds, reinforce administrative capacity and improve the reporting of irregularities. The law seeks to address situations where politicians and government officials might use their position against the public interest. The law also prevents the preparation of bidding documentation by certain candidates. The most recent 2010 amendment to the law regulate the establishment of a

<sup>63</sup> *Status of Implementation of EU Funds in Bulgaria on 31 July 2009*, EC report, <http://eulaw.wordpress.com/2009/10/27/commission-reports-on-eu-funds-in-bulgaria-and-romania/>; Interim reports of the EC to the European Parliament and the Council on Progress in Bulgaria under the Co-operation and Verification Mechanism during 2008–10.

<sup>64</sup> For instance, *Annual Report on the EU Funds Absorption in Bulgaria* for 2009 (in Bulgarian), 2010, <http://www.parliament.bg/bg/parliamentarycommittees/members/240/documents>.

<sup>65</sup> Formula Europa Institute, 2008: *A study of European Funds Management and Its Effectiveness in Promoting Economic Development in Bulgaria*; Stefanov R., Mineva D., 2010, Expert Evaluation Network: *Deleveraging Policy Analysis on the Performance of Cohesion Policy 2007-2013 in Bulgaria*, Report to the European Commission Directorate General Regional Policy.

<sup>66</sup> The law is available in Bulgarian on the internet. The recent 2010 amendments are published on the website of the Parliament: <http://www.parliament.bg/bg/laws/ID/9924/>.

#### **Box 4. Main Measures Implemented to Accelerate Absorption of EU Funds, 2009–13**

Advance payments for the investment projects and operational expenditures have been increased from 20 to 35 percent.

Monthly briefs and financial data on the implementation of the SCF are available on the single web portal (<http://www.eufunds.bg/>).

The deadline for verification and payments to the beneficiaries has been reduced to max 2½ months.

Introduction of a methodology on financial corrections of projects with irregularities, other than frauds.

Mandatory public consultation at least 10 days before the launch of a call for tender was introduced.

The management of OP Regional Development has collaborated with the Municipalities' Association to boost the implementation of the projects at the municipality and regional level.

A number of corrective measures and procedures for management of the projects in the sector of water and waste and changes in the management of OP Environment have been introduced. All municipalities, depending of their readiness, have been invited to submit the projects for the OP Environment despite the fact that for 2010 OP Environment envisaged financing only for the beneficiaries of the priority axes covering water and waste.

Training vouchers financed by OP Human Resources have been awarded to employees and unemployed in order to meet the present labor market challenges.

Improved communication with beneficiaries: the government established a mechanism for regular monthly meetings with representatives of municipalities, managing authorities, certifying authorities and the Central Coordination Unit.

The responsible directorate at the CoM enters all available information from the MAs of the OPs in the UMIS on the EU funds Information Portal: [www.eufunds.bg](http://www.eufunds.bg) and updates the information on a regular basis.

With the CoM Act 81/2010, VAT refunds to the municipalities and beneficiaries of the Program for Rural Development and SCFs OPs have been introduced.

A methodology for verification and adjustment of prices of construction works for infrastructure projects under OP Regional Development has been introduced.

Changes of the primary and secondary legislation, including the Law on Preventing and Disclosure of Conflicts of Interests and Ordinance for Implementation of Preliminary Control Procedures in the Public Procurement have been adopted.

The 2012 Amendments to the Public Procurement Law are in line with the Commission's recommendations and the lessons learned from the implementation period 2007–10. About 70 percent of the EU funds projects are subject to the Public Procurement Law and its effective implementation is thus of the highest importance for the EU funds absorption. The implemented amendments have already allowed ex-ante control of the bidding documentation of all projects with EU financing by Agency for Public Procurement and thus avoiding conflicts of interest.

Introduction of electronic application for EU funded projects to simplify the application process.

Opening of an EU funds information center to assist the beneficiaries in the application and implementation process. The information for it is available on the EU funds web portal [www.eufund.bg](http://www.eufund.bg).

**Box 4 cont. Main Measures Implemented to Accelerate Absorption of EU Funds, 2009–13**

Creating mobile groups of experts to assist the beneficiaries in resolving problems related to the EU projects realization.

Proposed additional amendments to the procurement legislation in mid-2013 mainly aimed at involving small and medium-sized companies in EU funded infrastructure projects, which now typically participate as sub-contractors, and to introduce an electronic public procurement procedure through an online platform, which would improve accountability and transparency of the procurement process.

Active usage of the EC and IFIs initiatives for technical assistance and support for preparation of the large EU funded projects. Involve experts of the EBRD, the EIB and the World Bank in preparation of the big infrastructure and environment projects. Involve experts of the EBRD in the implementation of the energy efficiency scheme under OP Competitiveness.

Cooperating with banks on the EU funds implementation using JEREMIE, JESSICA and JASPERS initiatives (see Box 5 for details).

specialized commission in the parliament to improve its enforcement and increase its effectiveness through the application process, which was also one of the EC recommendations.<sup>67</sup>

**To ensure that the management and control systems of the OPs are in line with the EU requirements, the EC has assisted Bulgaria in re-submission of its compliance assessments.** In July 2009, the EC provided detailed comments and recommendations concerning the management and control systems of Bulgaria's and Romania's pre-accession and post-accession funds.<sup>68</sup> As a consequence of the mutual efforts, the EC recognized report that "Bulgaria establish central coordination for management of EU funds, implemented a law to protect against conflict of interest and took corrective measures in relation to projects under risk. Bulgaria also implemented measures to ensure cost-efficiency of projects".<sup>69</sup>

### **Measures to Address Weak Administrative Capacity**

**The guidelines for rules and procedures for granting aid under OPs by the CA to the MAs were rigorous in order to avoid deficiencies, irregularities and fraud, but were also quite cumbersome for applicants.** The preparation of instructions on rules and procedures, as well as practical guidance concerning preparation of the application documentation, implementation of projects, verification and certification of eligible expenditures, functioning of the management, and control systems of the OPs were not ready at the beginning of the program period. Furthermore, with a view to reduce the risk of fraud,

<sup>67</sup> *Interim Report of the EC to the European Parliament and the Council on Progress in Bulgaria under the Co-operation and Verification Mechanism*, 2010.

<sup>68</sup> *Status of Implementation of EU Funds in Bulgaria on July 2009*:

<http://eulaw.wordpress.com/2009/10/27/commission-reports-on-eu-funds-in-bulgaria-and-romania/>.

<sup>69</sup> Ibid.

the project preparation got complicated—even more complicated than required by EU legislation. Finally, staff responsible for management and planning did not have enough experience and needed time to learn the UMIS and the EU LOTHAR forecasting system.<sup>70</sup> These tools had to be more standardized to help alleviate weak administrative capacity.

**In 2009, the EU Structural Funds Single Information Portal was almost ready but needed further development to become effective for the management and control process.** UMIS became a core component of the portal,<sup>71</sup> but in the beginning it did not ensure enough information for audit findings. Until 2011, the system's information did not provide updated data on the OPs for rural and fishery sectors.

### **Application Process**

**At the beginning of the program period 2007–13, the application process was very cumbersome.** The repeated rejection of compliance assessment reports on management and control systems of the OPs and lack of prioritization in the announced grant schemes impeded and prolonged the absorption process. The authorities' decision-making process did not ensure consultations to achieve broad consensus among the respective parties. The assessment of applications was hindered by the complicated decision-making and implementation approach applied by the MAs. The cumbersome procedures for evaluating project proposals and delays in the final decision of the MAs created delays and the perception of possibilities for corruption.

**To accelerate the application process, the EU recommended the introduction of higher salaries for staff working on EU funded projects.** The monthly salary has been increased and became twice as high as the salary of the other government experts with the similar positions. However, the salary was not related to finishing the project, so there was an incentive to keep the project alive. Furthermore, it created a “class society” within the ministries between those working on EU funds and the others. The EU funds experts have been trained under different projects financed by OP Technical Assistance that did improve their administrative capacity and performance. After gaining such experience, many of them moved to the private consulting companies, which paid better. The turnover of the experts in the MAs has become an obstacle for smooth and effective management process.

### **Tender and Procurement Process**

**The organization and implementation of tender procedures, including slow preliminary review of bidding documentation by the Agency of Public Procurement and the MAs, was another shortcoming.** The preparation of the bidding documentation needed about two months for small projects, but big infrastructure projects could take years. The time for

<sup>70</sup> The EU LOTHAR is a system, based on Excel, for the preparation of financial forecasts for the absorption of EU SCFs and monitoring of their implementation. The main parameters of the system are total amount of contracts, payments and certified payments reported to the EC.

<sup>71</sup> It consists of the following modules: Parameters, Register, Evaluation, Contracts, Project Management, Financial module, On-Site Control and Irregularities Management, Monitoring and Administrative. An interface between the SAP accounting system of the MAs and the UMIS has been established.

preparation depends on the readiness of the beneficiary with the appropriation of land, as well as the cost-benefit analysis required by the EC. The bidding documentation is provided to the Agency of Public Procurement and the MAs for preliminary review, which require about one month.

**After the evaluation of the proposals and announcement of the winner, tenders were frequently appealed, mainly due to the stated procedures and on suspicion of conflicts of interest, which impeded the process.** The losers had an incentive to “hassle” the winner, with a view to “persuade” the winner to give them a share of the contract. This has been changed with the Protection Competition Law adopted in 2008. Currently, appeals can be launched within 10 days and the loser has to pay a fee and a guarantee<sup>72</sup> to the Protection Competition Commission, which makes an assessment and recommendations within two months. If the contestor is still not satisfied, he/she can appeal to a court, which usually takes a month, so, in principle, a decision is found within about four months. In practice, these deadlines are observed for small projects. For the big infrastructure and environmental projects there are additional obstacles, which can delay the project implementation, such as environmental requirements, etc.<sup>73</sup>

**Land appropriations for big infrastructure projects pose a special challenge.** The procedure itself is long and complicated, because different central and local government institutions are involved. Moreover, some land owners complain and contest the price offered for the land. This, however, seems to have been solved. After the completion of the procedure, the CoM takes the decision based on the proposal of the Regional Development Ministry in concert with the respective municipality. As a result, it still can take years to complete the whole procedure for the beneficiary to appropriate the land for the project and pay compensations to the owners, but it will no longer stop the implementation of the project.

**The 2012 amendments of the public procurement law simplified and unified the ex-ante control procedures.** They aimed at avoiding typical mistakes of beneficiaries, especially municipalities, identified in the first years of the post-accession period. As a result, the ex-ante control of the bidding documentation by the Agency for Public Procurement is now applied for all EU projects, which helps avoid financial corrections.

**Remaining shortcomings of the public procurement law are expected to be resolved with the proposed 2013 amendments.** Small and medium-sized companies will be given better access to public projects, including EU funded projects. Development of an e-public

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<sup>72</sup> The fee depends on the project: for small projects—about Lev 600; for projects above Lev 110,000—Lev 850; and for the projects for which the Protection Competition Commission has to send information to the EC—Lev 1700. Additionally, the Protection Competition Commission determines also a guarantee in each case.

<sup>73</sup> The Sofia Waste Plant project, which will be financed with the EU funding, is one example. The procurement procedure for the main component—the waste treatment plant was completed—but to take decision on its financing, the EC required additional information on financial parameters, which delayed the project implementation more than a year and a half. On the other hand, the public procurement order for one of plant installations—for green and food waste compost—had been terminated a year after it was announced, despite the fact that the EC had already approved its financing. The reason was that there was only one bidder, who complied with the price criteria, and the Sofia Municipality had to start a new procurement procedure.

procurement procedure through an online platform for all bidders will include more information about the decisions of the committee and hence improve accountability and transparency of the procurement process, and ultimately promote public confidence in the procurement process.

### **Co-Financing, Resources and Payment**

**Lack of co-financing and up front recourses have been another obstacle for accelerated absorption.** Co-financing is introduced to ensure that the beneficiary is committed to and has ownership in the project. Indeed, in addition to the co-financing, which varies between 15 and 20 percent for most projects, the beneficiary also has to pay the VAT and the appropriation of land for infrastructure projects, so the effective domestic contribution may be much more than 20 percent—in some cases even more than 40 percent. If insufficient co-financing is the constraining factor, it may suggest that these are not priority projects. The Bulgarian authorities have taken several measures to address this challenge:

- In 2007, a Framework Agreement between the Bulgarian government and the European Investment Bank (EIB)—on financing the co-financing share—amounting to €700 million was signed with a view to support the implementation of the projects financed by SCF funds. So far, Bulgaria has received €279.4 million.<sup>74</sup>
- In 2007, the government established the Bulgarian Fund for Local Authorities and Governments (FLAG)<sup>75</sup> to facilitate co-financing of municipal infrastructure projects that can benefit from EU funds. To accumulate resources, FLAG signed a long-term loan agreement with the EBRD. It has been operating since January 2009 and supports smaller municipalities and municipality-owned utilities in the area of reconstruction of social infrastructure and road rehabilitation. For the period 2009–12, about 400 municipal projects amounted to Lev 113.4 million have been financed through FLAG.<sup>76</sup>
- In 2010, with a view to overcome the crisis, advanced payments were increased up to 35 percent for public beneficiaries of OP Regional Development, OP Transport and OP Environment to accelerate the absorption.<sup>77</sup> Before, about 20 percent of the project's budget could be made available as advance payment, but it rarely covered pre-financing needs of beneficiaries. Moreover, the slow process created financial problems and prevented the beneficiaries from submitting new applications. Instead of waiting for certification, verification by the MA became sufficient to release advance and interim payments.<sup>78</sup> In practice, however, it means the MA has the fiscal

<sup>74</sup> Of which €52.4 million in 2012, €82.4 million in 2011, €50 million in 2012, and €94.6 million in 2013.

<sup>75</sup> The types of projects supported by FLAG include local water and sewer investments, waste management, local road rehabilitation and energy efficiency measures in public buildings. Sub-loans are also used for project preparation, including feasibility studies and preparation for grant applications.

<sup>76</sup> FLAG Consolidated Financial report for 2012: <http://www.flag-bg.com/?id=564>.

<sup>77</sup> For the other SCFs OPs the advance payments remained 20 percent.

<sup>78</sup> Advance payments are released in the beginning and they do not depend on verified expenditures. Interim payments are provided by the MAs after verification of the eligible expenditures.

responsibility, if certification cannot be achieved at a later stage, which poses a significant risk to the budget.

- For beneficiaries, which are public enterprises or public sector entities, a letter of comfort from a bank has to be provided at the time of application. This has to ensure that these projects are indeed “bankable” and will not be stopped after they have been through a time-consuming application process.
- The budget now also includes multi-year aspects for EU funded projects, hence ensuring that if a project is started, the co-financing will also be made available in future years. Multi-year budgeting is not yet introduced in Bulgaria, but in order to extend the fiscal horizon beyond the annual budget, the Bulgarian government is preparing on rolling basis medium-term budgetary framework, which provides a coherent quantitative statement of the government fiscal strategy.

### **Preparation, Monitoring and Verification Process**

**The low level of project readiness in key infrastructure projects, problems with expropriation of real estate procedures and environmental estimates delayed big infrastructure and environmental projects.** The involvement of consultants from IFIs under the EC initiatives for the preparation phase of the projects was delayed and the country lost pace. This has now been changed and Bulgaria has started benefiting from JASPERS, for instance, which provides resources for technical assistance in the area of transport and other projects with capital costs higher than €50 million and environment projects with capital costs higher than €25 million.<sup>79</sup>

**The monitoring process also initially suffered from the insufficient administrative capacity.** Initially, the incomplete and not fully integrated UMIS hindered central oversight and ordination. There was even a risk of suspension of approval limits for interim and final payments on all OPs due to shortcomings in the functions of UMIS. The system proved inadequate and inconsistent and resulted in audit opinions. Moreover, increased requirements of project justification and lack of efficiency of the chosen technologies caused problems for some projects. As previously noted, the rate of staff turnover has been very high and impeded the capacity to monitor and evaluate many projects.

### **Auditing and Fraud Prevention**

**Problems not addressed in a timely manner have typically been found during audits or during the certification, and some of these deficiencies and irregularities resulted in**

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<sup>79</sup> In 2011, JASPERS has completed assignments for 19 projects in Bulgaria and 60 other projects were in progress. The main completed projects are Sofia Metro Extension (phase one); Burgas Integrated Urban Transport Project; project for electrification and reconstruction of some railway lines; projects for closure and rehabilitation of some cities' landfill; assessment of the preparation process for water and wastewater projects in some cities. Other big infrastructure projects, such as Trakia Motorway, Maritza Motorway, Henus Motorway connection to Sofia Ring Road; Kardjali-Podkova Motorway; and Struma Motorway are in progress.



**financial corrections and repayment to the EU budget.** The MoF auditing agency of EU funds performs the audit function on behalf of the EC. In order to provide reasonable assurance to the EC regarding the legality and regularity of expenditure declared to the EC for reimbursement under the OPs, and observing internationally accepted auditing standards, the agency performs two types of audits: one on operations and one on management and control systems.<sup>80</sup> The audit agency takes into consideration the results of these audits and issues on each OP an annual audit report and audit opinion, which is presented to the EC. The procedure includes clearance of accounts, required additional information to prove the eligibility of some of the expenditures and financial correction, if needed.

**The recommendations of the audit agency of the EU funds have contributed to the improvement of the EU funds' tender and verification procedures.** The publishing of a sample of common errors of beneficiaries in the tender procedure was a recommendation of the auditors. Some typical mistakes were made by beneficiaries implementing the rules for pre-accession funds instead of post-accession funds. Most of them were not deliberately made, for instance not publishing of the tender order in the Official Journal of the EU, but this omission is (i) a breach of explicit legal requirement of Directive 2004/18/EC, and (ii) is qualified as significant non-compliance with the principles of publicity and transparency as required by Directive 2004/18/EC. In such cases, a proportionate flat rate correction of 25 percent of the expenditure under the affected contract has to be applied, in accordance with the EC Guidelines for determining financial corrections (COCOF 07/0037/03-EN).

**Some municipalities, for instance, have implemented projects for which the funds will be not reimbursed by the EC and they have had to cover the resources spent from their budgets.** The mutual meetings of the municipalities association and the audit agency for the EU funds have now become a practice facilitating proper implementation of EU funded projects and tender procedures, in order to avoid unconscious irregularities later found by the audit agency.

### C. Measures Taken by the EU and Other International Institutions

**Experience has shown that the absorption of EU SCFs is a challenge in all new member states.** Therefore, EU institutions have taken several initiatives to assist the CEE member states. In 2008, the EC announced the *European Economic Recovery Plan* as an EU response to the economic crisis.<sup>81</sup> In 2010, a Memorandum of Understanding was signed with the World Bank to leverage absorption with financing and technical assistance (Box 5).

<sup>80</sup> Regarding the control process, the auditors checked a sample of 72 projects for OP Human Resources and OP Administrative Capacity, and 100 percent of the certified expenditures of OP Environment, OP Transport and OP Regional Development. If the auditors find 2 percent irregularities in their sample of projects, they expand the audit to all new projects of the same OP.

<sup>81</sup> On August 1, 2011, the EC proposed to the European Parliament and the Council to adjust the current system of EU co-financing in cohesion, fisheries and rural development policies for some member states that have been most affected by the crisis and have received financial support under a program from the Balance of Payments Mechanism until end-2013. The EU contribution was increased to a maximum of 95 percent, if requested by a member state concerned. The proposal related to countries not in the Euro area (Romania, Latvia and Hungary)

(continued)

### **Box 5. EC, EBRD, EIB and World Bank Initiatives for EU Funds Absorption**

**In 2005, the JASPERS initiative (Joint Assistance to Support Projects in European Regions) was set up** as a free of charge program to assist the CEE member states in the preparation of major projects to be submitted for grant financing under the Structural and Cohesion Funds. JASPERS areas comprise transport and other projects with costs higher than €50 million and environment projects with costs exceeding €25 million. JASPERS is managed by a team of experts from the European Investment Bank (EIB), European Commission (DG REGIO), European Bank for Reconstruction and Development (EBRD) and Kreditanstalt für Wiederaufbau (KfW). In 2011, Bulgaria had 19 EU projects for which JASPERS assignments had been completed and 60 projects were in progress, while 35 new projects were added in 2012.

**In 2006, the JEREMIE initiative (Joint European Resources for Micro to Medium Enterprises) was developed** by the EC and the European Investment Fund (EIF), which is part of the EIB Group. It offers EU member states, through their national or regional EU funds' managing authorities, the opportunity to use part of their SCFs to finance SMEs by means of equity, loans or guarantees. A revolving Holding Fund acts as an umbrella fund targeting financial intermediaries, not SMEs directly. The signed JEREMIE Funding Agreements for the member states amount to €1161.5 million. On May 26, 2010, Bulgaria's Parliament ratified the framework agreement between Bulgaria and the European Investment Fund to allow the launch of the JEREMIE initiative with funding amounting to €199 million. On June 6, 2012, an agreement for amendment and supplement of framework and funding agreement was signed for €133 million. The JEREMIE initiative is funded by OP Competitiveness and will control all finances on behalf of the Bulgarian government. A JEREMIE Bulgaria EAD, a joint stock company incorporated under Bulgarian law wholly owned by EIF, was established. On July 14, 2011 Bulgarian Minister of Economy, Energy and Tourism signed guarantee agreements with EIF, ProCredit Bank, Raiffeisenbank, United Bulgarian Bank and UniCredit Bulbank under the JEREMIE initiative.

**In 2006, the JESSICA initiative (Joint European Support for Sustainable Investment in City Areas) was launched** to help the member states exploit financial engineering mechanisms to support investment in sustainable urban development in the context of cohesion policy. It allows managing authorities to use some of their structural fund allocations—principally those supported by the European Regional Development Fund (ERDF) but also, where appropriate, the European Social Fund—to invest in Urban Development Funds to accelerate investment in urban areas. A Memorandum of Understanding to coordinate the efforts of the Commission, the European Investment Bank and the Council of Europe Development Bank on urban projects was subsequently signed on May 30, 2006. On July 29, 2010, the EIB, responsible for the JESSICA program, and Bulgaria signed an agreement establishing a JESSICA Holding Fund. The €33 million fund, including €28 million from the ERDF is complemented by €5 million of Bulgarian national co-financing. This will focus on revenue-generating, urban development projects, including the rehabilitation of deprived urban areas in seven big cities across the country and will allow implementing Bulgaria's 2007–13 OP Regional Development, which has a strong urban development focus.

**The JASMINE initiative (Joint Action to Support Micro-finance Institutions in Europe)** is promoted and managed by the European Investment Fund. It is a European initiative for the development of microcredit in support of growth and employment, but not for absorption of EU structural funds.

**In December 2008, the EBRD extended a €35 million credit to FLAG to strengthen the institutional capacity of the local authorities** to develop suitable projects and to support municipal projects for the rehabilitation of municipal infrastructure alongside Unicredit and HYPO Investment Bank.

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or from the European Financial Stabilization Mechanism for countries in the Euro area (Greece, Ireland and Portugal): <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/942&format=HTML>.

**Box 5 cont. EC, EBRD, EIB and World Bank Initiatives for EU Funds Absorption**

**In November 2008, the EC announced the European Economic Recovery Plan as an EU response to the economic crisis.** It consists of four types of measures: monetary and credit policies, fiscal policy, Lisbon-type structural reform and external co-operation with a demand national and EU level stimulus of €200 billion, equivalent to 1.5 percent of EU's GDP. DG REGIO has put forward a proposal for changes in the Regulations that guide the provisions for the EU funds in relation to the economic crisis. The CEE countries will receive an additional 2 percent, equivalent to about €4.5 billion.

**In August 2010, World Bank and Bulgaria signed a Memorandum of Understanding to cooperate on the development of Bulgaria's infrastructure,** including accelerating maintenance and investment in roads and railways to boost the Bulgaria's competitiveness and foster economic growth by leveraging EU funds with financing and technical assistance support from the World Bank.

## V. CONCLUSION

**This paper has provided an overview of Bulgaria's absorption of EU post-accession funds during the 2007–13 program period and their potential impact on demand and growth, while identifying specific measures to further effective absorption during the next program period.** EU funds could be a useful demand management tool to mitigate a recession, but it would require having fully prepared EU funded projects ready in the pipeline that could be implemented when required by the business cycle. Experience shows that this is difficult. Nevertheless, efforts should be intensified to properly prepare EU funded projects early during the program period. EU funds can also increase long-term potential growth, but only if they are used effectively to increase the production possibility frontier. Using EU funds as a demand management tool as well as to increase medium-term potential output require good public financial management and governance practices, as EU funds absorption is prone to similar inefficiencies that have haunted development aid. Instead of focusing on a high degree of absorption due to the grant element, the primary objective should be to use these funds for projects that give an adequate social rate of return. Bulgaria has taken many successful measures to improve EU funds absorption, but some additional steps—listed in sub-section A in the Introduction (page 9)—would help ensure more effective, efficient and timely absorption during the next program period.

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## APPENDIX I. POST-ACCESSION FUNDS IN VARIOUS EU COUNTRIES: EXPERIENCES AND LESSONS

**The experience gained and challenges faced by the member states regarding EU funds absorption may provide some useful lessons and are summarized in this Appendix (Table 5).**

Table 5. The Main Success Factors and Obstacles of EU Funds' Absorption

Main success factors	<p>Political commitment</p> <p>Forceful and effective inter-ministerial coordination and capable institutions</p> <p>Simplified planning and implementation system</p> <p>Prompt support to weaker areas in overcoming gaps and weak capacity</p> <p>Effective systems for management and control of the OPs implementation, including to fight corruption</p> <p>Transparent and user friendly legislative procedures, including in public procurement area</p> <p>Promotion of financial instruments supporting the beneficiaries</p> <p>Promoted partnership and consensus of different parties regarding the process<sup>82</sup></p>
Main obstacles	<p>Poor administrative capacity, insufficient skills and resources</p> <p>Inconsistency in the modules of the management and control systems of various OPs</p> <p>Fragmentation of the process</p> <p>Confused processes with no guidance provided and cumbersome application procedures</p> <p>Large administrative burden</p> <p>Lack of beneficiaries' capacity for preparation of projects</p> <p>Insufficient financing of beneficiary to sustain the process</p> <p>Problems with tender procedures</p> <p>Problem with land appropriations for big infrastructure projects</p> <p>Long deadlines for payments to the beneficiaries</p> <p>Weak monitoring systems</p> <p>Lack of transparency in technical and financial validation by the MAs</p> <p>Financial instruments are inaccessible and not promoted</p> <p>No active involvement of IFIs and banks</p> <p>Financial irregularities and frauds during the implementation of the projects.</p>

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<sup>82</sup> The *Scotland Europa Report* "Best Practice for Simplification of EU Programs", January 2011, underlines that partnership is one of the more important success factors. Establishment of effective specialized organizations can contribute to a coherent partnership among different parties and promote a country's interest across EU institutions. Such organizations foster successful relationships, providing guidance on European policies and funding. They help the authorities to explore and identify best practices, which could be adopted, or promoted in future programs.

**The old EU members' experience shows quite different results.** The impact of the SCFs absorption on GDP per capita of Ireland, Spain, Portugal and Greece during the two EU program periods 1989–93 and 1994–99<sup>83</sup> show that there is no single recipe, but a variety of contributing factors to success (Table 6).

Table 6. The Experience of Ireland, Spain, Portugal and Greece in the 1989–99 Period

Ireland (joined the EU in 1973)	<p>In part due to the efficient absorption of SCFs, Ireland managed to achieve enormous increase in GDP per capita—from 64 percent of the European average in 1986 to 111 percent in 1999—and thus became one of the best examples among the old member states.</p> <p>The Economic and Social Research Institute in Dublin in its Report on Mid-Term Evaluation of the CSF for Ireland, 1994–99<sup>84</sup> identified three main reinforcing factors contributed to Ireland's success:</p> <ul style="list-style-type: none"> <li>• Gradual accumulation of human capital;</li> <li>• Fiscal control;</li> <li>• Maintenance of wage competitiveness.</li> </ul> <p>Partnership became a part of culture and was integrated in the general policy making process.</p>
Spain (joined the EU in 1986)	<p>SCFs absorption probably contributed to Spain's increase in GDP per capita from 70 percent of the European average at the time of EU membership in 1986 to 80 percent of the European average in 1999, although a range of other factors may also have contributed.</p>
Portugal (joined the EU in 1986)	<p>The SCFs disbursement in Portugal coincided with an increase in GDP per capita from 54 percent of the European average in 1986 to 74 percent in 1999. Several factors may have contributed to this success:</p> <p>Portugal focused on strong regional coordination. Before EU accession, municipalities were delegated specific authority over certain public investments, which facilitated SCFs absorption. Municipalities were able to take decisions and prioritized their projects.</p> <p>Regional structures were established. Municipal associations were encouraged to foster the implementation of the regional OPs.</p>
Greece (joined the EU in 1973)	<p>Greece joined the EU in 1973, but in spite of SCFs disbursement, GDP per capita only rose from 61 percent of the European average to 69 percent in 1999.</p>

<sup>83</sup> Sources: Bradley, J., 1999, Reviewing Bulgaria's progress towards EU membership Sofia, Conference on 9th November 1999; Partnerships in Structural and Cohesion Funds Planning and Absorption: A comparative review of the practices of selected EU Member States and lessons learned for Bulgaria, UNDP Bulgaria Report 2006, p. 58.

<sup>84</sup> "EU Structural Funds in Ireland - A Mid-Term Evaluation of the CSF 1994–99", by the Economic and Social Research Institute, *Policy Research Series Paper* No.31, July, 1997.

**The CEE countries have showed initially very different level of preparedness and applied their own specific strategies to boost the SCFs absorption<sup>85</sup> (Table 7)<sup>86</sup>.**

Table 7. The Experience of CEE EU Countries during the 2007-13 Program Period

Latvia	<p>Latvia's absorption rate of SCFs was 56 percent at end-2012. Latvia increased the efficiency of the institutions through promoting a client-oriented approach and reducing the administrative and financial burdens on beneficiaries, facilitating the application procedures through legislative modifications.</p> <p>It introduced weekly reports to follow-up the improvement of payment rates and further measures if needed.</p>
Lithuania	<p>Lithuania's absorption rate of SCFs was 59 percent at end-2012. It was the best in dealing with the European Regional Development Fund.</p> <p>It developed the Economic Stimulus Plan bolstering employment, business promotion and energy efficiency.</p>
Slovenia	<p>Slovenia's absorption rate of SCFs was 50 percent at end-2012. It has a strong inter-ministerial coordination and quality institutions, which organized meetings with potential applicants and advised smaller companies.</p> <p>It simplified the procedures for payments and approved VAT as an eligible expenditure.</p> <p>It also relied on timely announcement of public tenders, separating them for small and large-scale projects and exercising on-the-spot control.</p>
Czech Republic	<p>The Czech Republic's absorption rate of SCFs was 57 percent at end-2012. The Czech Republic introduced a national model for cost-benefit analysis and a risk control system in order to speed up the implementation of the major infrastructure projects and managed to triple disbursed funds in one year.</p>
Estonia	<p>Estonia's absorption rate of SCFs was 59 percent at end-2012. Estonia introduced a procedurally simpler and faster implementation system.</p> <p>Priority was given to projects with the higher EU funding, such as transport, environment and economic development.</p> <p>In 2010, the authorities reallocated some of the resources to overcome the consequences of the economic crisis.</p>
Slovakia	<p>The authorities took additional measures to boost the process and now the MAs can provide advance payments to all beneficiaries.</p>

<sup>85</sup> *EU Funds in Central and Eastern Europe, Progress Report 2007–10*, KPMG, 2011; and *EU Funds and Eastern Europe, Progress Report 2007-12*, KPMG, 2013; and (IPP, 2013).

<sup>86</sup> Obviously, correlation between an increase of EU funds absorption and GDP per capita does not necessarily imply causality.

Table 7 cont. The Experience of CEE EU Countries during the 2007-13 Program Period

Hungary	<p>Hungary's absorption rate of SCFs was 40 percent at end-2012. Hungary concentrated its efforts on the implementation of the New Hungary Development Plan and reallocation among and within the various OPs.</p> <p>It relied on creating less strict eligibility criteria through increasing support and grant sums from the national budget and decreasing growth expectations for the period after the realization of the programs.</p> <p>The payment deadline was reduced from 60 to 15 days and authorities have to pay penalty interest in case of late payments.</p> <p>A system of ex-ante control of the documentation was introduced.</p>
Poland	<p>Poland's absorption rate of SCFs was 49 percent at end-2012. Poland contracted promptly large infrastructure projects and its average contract ratio of 53 percent but has experienced delays in payments following the pace of the implementation of various projects.</p> <p>The Ministry of Regional Development has been vested with management of all EU funds and coordination of the activities of respective ministers, self-government units and socio-economic partners within the area of the development policy.</p>
Bulgaria and Romania	<p>At end-2012, the absorption rate of SCFs was 34 percent for Bulgaria and 12 percent for Romania (IPP, 2013). Bulgaria and Romania joined the EU three years later than other CEE countries, but at the beginning of the program period 2007–13, the problems were quite similar. However, Bulgaria seems to have overcome the shortcomings faster than Romania (IPP, 2013), as the absorption rate at end-June 2013 was 41 percent for Bulgaria and 18 percent for Romania.</p>

## APPENDIX II. POST-ACCESSION FUNDS: OVERVIEW OF TYPES OF BULGARIAN OPS

**This Appendix provide details on Bulgarian OPs<sup>87</sup> financed from Structural Funds, the Cohesion Fund, European Agricultural Fund for Rural Development, and the European Fisheries Fund.<sup>88</sup>**

### Structural Funds and Cohesion Funds

#### 1. OP Transport

Strategic objectives	<p>Development of sustainable transport system, integration of the national transport system into the European transport system, and achievement of a balance between different transport types.</p> <p>Supports motorways, first class roads, and some second class roads.</p>
Priority axes	<p>1 "Development of railway infrastructure along the trans-European and major national transport axes".</p> <p>2 "Development of road infrastructure along the trans-European and major national transport axes".</p> <p>3 "Improvement of inter-modality for passenger and freight".</p> <p>4 "Improving the conditions for navigation on the maritime and inland waterways"</p> <p>5 "Technical assistance"</p>
Program Budget	<p>Total amount: €2.003.481.166</p> <p>European funding: €1.624.479.623</p> <p>National co-financing: €379.001.543</p>
Managing authority	Ministry of Transport: Coordination of Programs and Projects Directorate.
Main beneficiaries	<p>National Railway Infrastructure Company</p> <p>Road Infrastructure Agency</p> <p>Sofia Metropolitan</p> <p>Danube Exploration and Maintenance Agency</p> <p>State Enterprise "Port Infrastructure"</p>
Major projects	<p>1. Modernization of Vidin-Sofia railway line (along Trans-European transport corridor IV)</p> <p>2. Modernization of Sofia- Plovdiv railway line (along Trans-European transport corridors IV and VIII)</p>

<sup>87</sup> The operational programs are Transport, Environment, Regional Development, Human Resources Development, Competitiveness, Administrative Capacity, and Technical Assistance.

<sup>88</sup> The main source for this Appendix is *Annual Report on the EU Funds Absorption in Bulgaria for 2009*, National Assembly, 2010 (<http://www.parliament.bg/bg/parliamentarycommittees/members/240/documents>) with various updates from <http://www.eufunds.bg>.



3. Renewal of railway sections along Plovdiv- Bourgas railway line
4. Modernization of Sofia- Pernik-Radomir railway line (as part of Modernization of Sofia-Kulata railway line)
5. Modernisation of Sofia-Dragoman railway line (along Trans-European transport corridor X)
6. Renewal of railway sections along Mezdra-Gorna Oryahovitza railway line. Rail track renewal and related maintenance activities for signaling, telecommunications and catenary equipment
7. Reaching the technical and operational parameters of the road infrastructure in accordance with the European standards
8. Upgrading of road I-1 (E 79) Vratza-Botevgrad
9. Construction of bypasses along TEN-T network, Phase I
10. Construction of Struma Motorway
11. Construction of Maritsa Motorway
12. Extension of the Metropolitan Sofia from “Hemus” Hotel to Central Station and Central Bus Station”, “Drujba” and new terminal at the Sofia Airport
13. Improvement of the navigation on the Danube in joint Bulgarian - Romanian parts: from rkm 530 to rkm 520 - Bathin from rkm 576 to rkm 560 – Belene.

Main components of the projects

Construction works, signaling, telecommunications and information systems, supervision and long-term assistance.

Rail track renewal and related maintenance of signaling, telecommunications and catenary equipment.

Corridors IV, VIII and IX previously rehabilitated under the Transit Roads Rehabilitation Projects 1 and 2.

Upgrading the existing two lanes road to four lanes expressway with total length of 31.5 km.

Construction of several city bypasses.

Various construction works.

Improvement of the navigational conditions in the two critical sections on the Danube river at low water levels.

## 2. OP Environment

Strategic objectives	Improvement, preservation and restoration of the natural environment and development of environmental infrastructure.
Specific objectives	<p>Conservation and improvement of the water; improvement of waste management and soil protection; conservation of biodiversity and nature protection.</p> <p>Investment in sewage systems and water supply infrastructure for settlements with population equivalents above 2000 inhabitants.</p>
Priority axes	<p>1 “Improving and developing infrastructure for water and wastewater in settlements with over 2000 inhabitants and settlements with below 2000 inhabitants within the urban agglomeration areas”</p> <p>2 “Improvement and development of infrastructure for waste treatment”</p> <p>3 “Preservation and restoration of biodiversity”</p> <p>4 “Technical assistance”</p>
Program Budget	<p>Total amount: €1.800.748.085</p> <p>European funding: €1.466.425.481</p> <p>National co-financing: €334.322.604</p>
Managing authority	Environment Cohesion Policy Directorate, Ministry of Environment and Water
Intermediate unit	EU Funds for Environment Directorate in the Ministry of Environment and Water
Beneficiaries	Municipal administrations, associations of municipalities, basin directorates, regional inspectorates of environment and water, Department of National Parks, management structures of Natura 2000, and NGOs.
Major projects	<p>1. Kurdjaly waste water and sewage project</p> <p>2. Yambol waste water and sewage project</p> <p>3. Plovdiv waste water and sewage Project</p> <p>4. Kocherinovo - Construction of regional waste management centre</p> <p>5. Construction of regional waste treatment facilities in Stara Zagora region</p> <p>6. Construction of regional waste treatment facilities in Varna region</p> <p>7. Closure of the existing landfill for municipal solid waste – Rouse</p>
Main components of the projects	<p>Reconstruction of sewerage network</p> <p>Construction of sewerage network</p> <p>Extension of sewerage network</p> <p>New regional landfill</p> <p>Development of material recovery facilities</p> <p>Invessel composting facilities</p> <p>Windrow composting facilities for green waste</p> <p>Transfer station</p> <p>Development of recycling centers.</p>

### 3. OP Regional Development

Strategic objectives	Improving the quality of life and working environment with better access to major services and creating new opportunities for regional competitiveness and sustainable development.
	Development of the second and third class roads as well as municipal roads in the urban agglomeration areas.
	Investment in sewage systems and water supply infrastructure in settlements with population at or below 2000 inhabitants.
Specific objectives	Development of sustainable and dynamic urban centers associated with their less-urban peripheral areas, thereby increasing opportunities for prosperity and development.
	Providing better access to travel, telecommunication and energy networks in underdeveloped regions.
	Developing regional tourism and marketing of the region-specific tourism products with higher added value.
	Mobilization of regional and local technical and institutional capacities and resources to implement regional development policies.
Priority axes	1 “Sustainable and integrated urban development” 2 “Regional and local accessibility” 3 “Sustainable tourism development” 4 “Local development and cooperation” 5 “Technical assistance”
Program Budget	Total amount: €1.601.274.739 European funding: €1.361.083.546 National co-financing: €240.191.213
Managing authority	General Programming of Regional Development Directorate, Ministry of Regional Development and Public Works.
Beneficiaries	Companies and public institutions (municipalities and associations of municipalities, municipal or state enterprises, companies, public transport, medical and health facilities, social and educational institutions, local, regional and national tourism associations, regional administrations and others.
Major projects	1. Burgas Integrated Urban Transport Project 2. Varna Integrated Urban Transport Project 3. Sofia Integrated Urban Transport Project
Main components of the projects	Modernization of public transport Alternative modes of transport

#### 4. OP Human Resource Development

Strategic objectives	Improving the quality of life of Bulgaria's people through improving human capital, achieving higher levels of employment, increased productivity, access to quality education and lifelong learning, and promoting social inclusion.
Specific objectives	More and better jobs and higher productivity. Increased investment in human capital through better and more accessible education. More social capital, networks and partnerships and the development of social economy.
Priority axes	1 "Promotion of economic activity and development of the labor market" 2 "Increase productivity and adaptability of employees" 3 "Improving the quality of education and training in accordance with the needs of the labor market to build a knowledge-based economy" 4 "Improving access to education and training" 5 "Social inclusion and promotion of social economy" 6 "Increasing the efficiency of market institutions, labor, social and health services" 7 "Transnational and interregional cooperation" 8 "Technical assistance"
Program Budget	Total amount: €1.213.869.575 European funding: €1.031.789.139 National co-financing: €182.080.436
Managing authority	European Funds, International Programs and Projects Directorate, Ministry of Labor and Social Policy.
Intermediate unit	Ministry of Education, Youth and Science, Employment Agency and the Agency for Social Assistance.
Beneficiaries	Socio-economic partners, municipalities, NGOs, governmental institutions, social enterprises, community centers, representatives of different communities, education, training and research institutions, scientific organizations, employers, industry and sector organizations, and others.

## 5. OP Competitiveness

Strategic objectives	Development of dynamic economy through stimulating the development of the knowledge economy and innovation, competitiveness of Bulgarian enterprises, increasing investment and exports and creating a favorable business environment.
Priority axes	1 "Development of a knowledge-based economy and innovation activities" 2 "Increasing efficiency of enterprises and promoting supportive business environment" 3 "Financial resources for development of enterprises" 4 "Strengthening the international market positions of Bulgarian economy" 5 "Technical assistance"
Program Budget	Total amount: €1.162.215.551 European funding: €987.883.219 National co-financing: €174.332.332
Managing authority	Directorate General "European Funds for Competitiveness, Ministry of Economy and Energy.
Intermediate unit	The Bulgarian small and medium enterprises promotion agency, Ministry of Economy and Energy.
Beneficiaries	SMEs (including start-up), large enterprises, NGOs, universities and research institutions, experimental laboratories and research institutions, municipalities, district administrations, other institutions and organizations in support of business.

## 6. OP Administrative Capacity

Strategic objectives	<p>Improving the functioning of public administration to implement effective policies, quality service to citizens and businesses and creating conditions for sustainable economic growth and employment.</p> <p>Increasing the professionalism, transparency and accountability in the judiciary.</p>
Priority axes	<p>1 “Good governance”</p> <p>2 “Human Resources Management”</p> <p>3 “Quality of administrative services and e-government development”</p> <p>4 “Technical assistance”</p>
Program Budget	<p>Total amount: €180.789.087</p> <p>European funding: €153.670.724</p> <p>National co-financing: €27.118.363</p>
Managing authority	<p>OP Administrative Capacity Directorate, Ministry of Finance.</p> <p>The composition, structure and functions of MA remain unchanged after moving the MA from the Ministry of State Administration and Administrative Reform to the MoF in 2009.</p>
Beneficiaries	<p>Central, regional and municipal administrations, bodies of the judiciary, socio-economic partners and NGOs.</p>

## 7. OP Technical Assistance

Strategic objectives	<p>Improvement of coordination, monitoring, implementation and evaluation of Structural Funds in Bulgaria for the period 2007–13.</p> <p>Provides tools and resources to ensure efficient functioning of the structures involved in coordination, management, certification, auditing and evaluation of Structural Funds absorption.</p>
Specific objectives	<p>Strengthening the capacity and functioning of the structures of the central and local administrations involved in SCFs absorption.</p> <p>Improving awareness and public awareness of effective and efficient use of Structural Funds and Cohesion Fund in Bulgaria.</p>
Priority axes	1. “Supporting the activities’ implementation of the central level structures; Capacity building measures for other SF implementing structures”
Program Budget	<p>Total amount: €56.819.427</p> <p>European funding: €48.296.513</p> <p>National co-funding: €8.522.914</p>
Managing authority	OP Technical Assistance Directorate, Council of Ministers.
Beneficiaries	<p>Central Coordination Unit;</p> <p>Central Information Office;</p> <p>Certifying Authority;</p> <p>Audit Authority;</p> <p>Managing Authority of OPTA;</p> <p>AFCOS Directorate, Ministry of Interior;</p> <p>Municipalities, on whose territory the administrative centers of 28 districts in the Republic of Bulgaria are;</p> <p>Archives State Agency;</p> <p>Public Procurement Agency;</p> <p>State Agency for Child Protection;</p> <p>National Association of Municipalities in the Republic of Bulgaria;</p> <p>Real Sector Finance Directorate, Ministry of Finance;</p> <p>Ministry of Economy and Energy</p>

## European Agricultural Fund for Rural Development (EAFRD) and European Fisheries Fund (EFF)

### 1. OP Rural Development

Strategic objectives	Improving the competitiveness of agriculture, forestry and processing industries, building local capacity and partnerships, diversifying the economy and improving quality of life in rural areas, protection of biodiversity and water resources.
Priority axes	1 "Improving the competitiveness of agricultural and forestry sector" 2 "Improving the environment and countryside (land management)" 3 "Quality of life in rural areas and diversify the rural economy" 4 "Leader" 5 "Technical assistance"
Program Budget	Total amount: €3. 279 billion EU funding: €2.642 billion, incl. €36, 830 million allocated to Bulgaria under the European Economic Recovery Plan National co-financing: €637 million
Managing authority	Rural Development Directorate, Ministry of Agriculture and Food.
Intermediate unit	The Payment Agency at the Agricultural Fund, Ministry of Agriculture and Food.
Beneficiaries	Farmers, younger farmers, producer organizations, SMEs, municipalities, NGOs, and educational institutions.



## 2. OP Fisheries' Sector Development

Strategic objectives	Transforming the fisheries sector into a competitive, modern and dynamic one based on sustainable development of fisheries and improving the quality of life in fishing areas.
Specific objectives	Ensuring competitiveness and sustainability of the fisheries sector; Developing the market of fisheries products and aquaculture production; Supporting the sustainable development of fisheries areas and improving the quality of life in those areas; Supporting the implementation of operational programs within the Common Fisheries Policy of the EU.
Priority axes	1 "Adaptation of the fishing fleet" 2 "Development of aquaculture production, processing and marketing" 3 "Promotion of activities of collective interest" 4 "Sustainable development of fisheries areas" 5 "Technical assistance"
Program Budget	Total amount: €106.679.611 European funding: €80.009.708 National co-financing: €26.669.903
Managing authority	European Fishery Fund Directorate, Ministry of Agriculture and Food.
Intermediate unit	Payment Agency at the Agricultural Fund, the Ministry of Agriculture and Food.
Beneficiaries	Owners of fishing vessels, fishermen associations and owners of fishing vessels and fishermen, private, public or public-private companies / organizations, associations or organizations of producers, ship owners for inland fishing; individuals; veterinary authorities; NGOs; State Enterprise "Fishery Resources of Foods"; national, regional and local authorities; market organizations; scientific and educational organizations.