

CHALLENGES AND THREATS ABOUT COST-BENEFIT ANALYSIS AND ABSORPTION OF STRUCTURAL FUNDS FOR INVESTMENT PROJECTS

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ABSTRACT

The purpose of this article is to present the role of cost-benefit analysis (CBA) in funding investment projects linked to the EU cohesion policy. The purpose of using ex-ante cost-benefit analysis has two aspects. On the one hand, the results of economic analysis must show that deserves and is likely to contribute to the objectives of the Funds. On the other hand, financial analysis is used to assess whether the project needs community support, therefore the so-called "deficit financing method" is then used to determine the level of EU subsidy. Romania would be in the center of this analysis as one of the recent members of the European Union and, as a consequence, a part of the strategy of integration. Given the relatively short time that could have been benefiting from the structural funds and on the global context of the financial crisis, Romania is facing an underutilization of the allocated funds.

KEYWORDS: *Cost-benefit analysis, absorption of the structural funds, Romania.*

JEL CLASSIFICATION: *E22, G31, H12, H19, H43*

1. INTRODUCTION

In the years to come there is an outlook of the extension of the European Union (EU) from 15 countries up to 26 countries; membership applications arrived in on the countries of Central and Eastern Europe (CEEC - Hungary, Poland, Romania, Slovakia, Latvia, Lithuania, Estonia, Bulgaria, Czech Republic and Slovenia) as well as Cyprus.

The effectiveness of Romania's integration into the EU implies attraction of net benefits that the European single market offers for the economy of Romania under the circumstances of a member country status, taking into account the commitments and obligations on short, medium and long term. In the new context of integration, the issue of increasing the absorption capacity of structural funds over the period 2008-2013 is a primary requirement for increasing economic competitiveness and sustainable development of Romania. The lesson of the new EU member states showed that during the first years of integration a lower absorption capacity of EU structural funds is registered, due to lack of experience and difficulties in developing eligible projects and non-compliance with Community requirements in terms of procedures and financing. Romania is no exception in this regard. Moreover, one should note that in 2007 and 2008, the first years of integration, the absorption capacity of Romania was much lower as compared to the new EU member countries belonging to the 2004 accession wave.

2. ABSORPTION OF THE STRUCTURAL FUNDS BY ROMANIA

Most of the factors causing a lower absorption capacity of Romanian local and central administration, as potential beneficiaries of EU funds, can be summarized in the following lines:

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1. low level of expertise and low qualifications regarding the accession and management of European funded projects;
2. low reaction regarding the process of elaboration, proposing for financing or evaluation and contracting of projects;
3. low financial and management capacity.

Table 1. Levels of Absorption of Structural and Cohesion Funds

Data Program	SOPT	Environment SOP	ROP	HDR SOP	OP IEC	OP ACD	OP TA	Average Level of Absorption
30-Sep-11	2.49%	1.89%	7.37%	2.96%	4.60%	4.73%	6.85%	4.41%
31-Oct-11	2.49%	1.89%	7.37%	2.96%	4.60%	4.73%	6.85%	4.41%
30-Nov-11	2.49%	1.89%	7.37%	2.96%	4.60%	4.73%	6.85%	4.41%
31-Dec-11	3.39%	2.12%	11.73%	5.48%	5.98%	9.08%	9.83%	6.80%
31-Jan-12	3.39%	2.12%	11.73%	5.48%	5.98%	9.08%	9.83%	6.80%
29-Feb-12	6.13%	2.54%	11.73%	5.48%	5.98%	9.08%	9.83%	7.25%
31-Mart-12	6.13%	3.38%	11.73%	5.48%	6.44%	9.08%	9.83%	7.44%

Source: www.dae.gov.ro

We appreciate that, to increase the European fund absorption capacity, the Romanian authorities should activate a number of specific factors, including:

- Strengthening the administrative capacity, also by preparing qualified personnel and avoiding fluctuation of employees in the system, both at the level of line ministries and the level of regional development agencies;
- Greater transparency by providing exhaustive information and elimination of excessive bureaucracy (which is generating corruption) from the system of financing project approval, but also by providing comprehensive information of public interest;
- Stabilization of the rules governing the access to structural funds, particularly the requirements of the Applicant Guidelines, avoiding further corrections that delay the approval of eligible projects;
- Completion of audit reports on the implementation of Operational Programs by the Management Authorities, so that they can be approved by the EU by the end of 2008 - conditionality for starting the reimbursements;
- The regulation of contractual relations among the different institutions at the central and local levels, between them and the consulting firms, namely the project beneficiaries, so that deficiencies in contract matters should no longer affect the deadlines for approving the funding, implicitly the rate of structural fund absorption;
- Establish performance criteria for consultancy firms agreed by the central Management Authority for the preparation of feasibility studies (including technical, if necessary) with severe penalties in cases of noncompliance with commitments assumed (quality and deadlines);
- Reducing the duration of the evaluation, selection and contracting procedures by increasing the quality, both for funding applications (providing all documentation required), and for Management Authorities and intermediary bodies;

- The inclusion both in the central and local budgets of the amounts planned by the central/local government for co-financing projects from the structural funds, complying with the conditions imposed by the state aid schemes Analysis at the level of the Ministry of Economy and Finance of all applications for eligible project funding, which, due to the fact that they exceeded the regional financial allocation they have been included in the reserve list, trying to find other sources for financing the projects of high national or regional interest.

Seeing the last statistics regarding the stage of absorption of structural funds, we may conclude that the absorption rate is low. So, according to statistics from February 2011, Romania succeeded in achieving the 9.87% from the total allocation of structural funds for period 2007-2013. Public institutions can contribute to local socio-economic development programs through the performance of the following functions:

1. improving decision making processes, including the quality of major investment choices (knowledge and human resources) and project selection (information, regulation and feedback mechanism);
2. ensuring a better implementation and enforcement of legislation;
3. improving the regulation mechanism especially through setting up a standardized model for quantifying the compliance costs imposed by issued regulation;
4. ensuring adequate framework for economic activities (human resources, data, legal);
5. improving the public decision making processes;
6. ensuring quality and efficiency in public service delivery;
7. increasing the number of civil servants who hold professional qualification in HRM, finance, economics and legislation.

The situation analysis identified three priority sectors for support - health, education and social assistance (National Strategic Reference Framework 2007-2013).

The basic idea is that the funds spent in these priority areas will seek to ensure that Romania has a sufficient, adequately trained, well managed work force, in good health so as to be able to develop the economy on competitiveness terms.

3. COST-BENEFIT ANALYSIS OF INVESTMENT PROJECTS

The basic notion of cost-benefit analysis is very simple. If you have to decide whether to do A project or not the rule is: Do A if the benefits exceed those of the next best alternative course of action, and not otherwise. . If we apply this rule to all possible choices, we shall generate the largest possible benefits, given the constraints within we live. And no one could complain at that. Going on a step, it seems quite natural to refer to the benefits of the next best alternative to A as the cost of A. For if A is done those alternative benefits are lost. So the role becomes: do A if the benefits exceed its costs, and not otherwise.

Cost-benefit analysis is a practical method for measuring costs and benefits of investment projects. Costs and benefits arise both today and the future, and for that reason, in order to be aggregated and brought into comparison, it is essential that all are expressed in a common measurement unit, money, and discounted at a certain moment in time.

Cost-benefit analysis, widely favored today as a technique for making public policy decisions, is a failure both in theory and in practice. In theory, it cannot comprehend important but priceless values, cannot escape the assumption that everything is for sale and can be traded off against everything else, and cannot accurately reflect the central role of uncertainty and the need for precaution in practice. It persistently tilts toward overstating costs, toward trivializing the future, and toward replacing clear policy debates with obscure technical quarrels.

With the public investment projects, a state's government doesn't aim to maximize the profit, as is the case of private sector, but to maximize the social welfare that is providing national defense, law

and order, education, road construction, and so on. This doesn't mean that public investment projects don't go through an efficient appraisal. Cost – benefit analysis allows the public authorities to achieve what a perfect market does, that is to allocate resources for a project entirely when the marginal social benefit exceeds the marginal social cost. Mendez (1992) regards that cost-benefit analysis, as a method of evaluating public investment projects, is much more advanced than corporation profitability analysis, but is not accurately applied.

Cost-benefit analysis requires definite numbers on each side of the balance sheet, to allow comparison of costs and benefits. Many important questions of environmental policy, however, involve inescapably uncertain outcomes. The European Commission sustained the development of Cost Benefit Analysis of national frameworks, focused on providing a set of common rules which are supposed to be guidelines for the promoters of national projects. This stage was implemented in order to increase responsibility of Member States.

As Ibraim (2010) presented in her thesis, a short list of countries which have implemented the sustained frameworks is made of:

- Czech Republic, Slovakia established these guidelines for water projects;
- Estonia, Ireland established both general and specific guidelines on water projects;
- Italy implemented a framework plus two recent working papers on establishing methodologies to assess employment and environmental impact of major projects;
- Lithuania and Poland developed guidelines for transportation projects.

4. PROBLEMS IN THE COST BENEFIT ANALYSIS

In the end it turns out that the Cost Benefit Analysis is not at all effective. In terms of decision making in a complex public policy, the problem is that there are many proposals and not enough time and resources. The only good solution in managing this problem is to have a possibility to adopt a proposal when total benefits exceed total costs. In real life Cost Benefit Analysis is a way to determine the next step after taking into account the costs and benefits of the proposals.

In general whenever future outcomes are uncertain the economists make estimations to benefits which are not characterized in monetary values, thus ignoring the concerns about worst case hazards that motivate many policy debates.

The majority of defects and biases within the application of Cost Benefit Analysis have its base in methodology (Kagitci&Buşu, 2012) and the demonstration is presented below:

4.1 Estimating values of benefits which cannot be defined in a monetary way

There is a problem in identifying the values of benefits which are hard or even impossible to be characterized by a certain sum. These benefits often refer to objects, states, feelings or goals which do not have a formula by which we can compute the sum of 100% achievement.

In these terms Cost Benefit Analysis cannot be applied as it needs absolute monetary values as labels for the targeted benefits.

With this at hand we might say that economists will not take into account the benefits which are not defined in a monetary way. Thus we discover a whole category of benefits which are of the utmost importance but which are considered priceless and are not deemed to be taken into account when looking at the big picture.

The term "priceless" is used whenever taking into account benefits which cannot be given a standard monetary value. This term has its base in Immanuel Kant's philosophies: "some things have a price, or relative worth, while other things have a dignity, or inner worth. No price tag does justice to the dignity of human life or the natural world. Since some of the most important benefits of climate protection are priceless, any monetary value for total benefits will necessarily be incomplete". Nowadays, economists are still trying to compare costs with benefits, meaning prices

with dignity. This has a very peculiar result! All benefits which cannot be deemed as material and receive a monetary value are characterized to by a ZERO COSTS label.

4.2. Problematic exchanges

Together with benefits which cannot be monetized we find the following assumption that anything has a price tag, meaning that everything can be exchanged for another thing. This situation raises the following problem: can costs be traded with benefits?

All valued things can be bartered, but this assumption is false in terms of "priceless" benefits. As their value cannot be determined results obtained with the Cost Benefit analysis are misleading as economists will use artificial or invented monetary values needed when using this method.

As a rule Cost Benefit Analysis considers that the impact of benefits is the same regardless of the recipient or the facilitator. In accordance with this mentality we can say that total net benefits of policies (benefits minus costs) when the European Union pays the costs and the Member State receives the benefits. However, people in general make a difference between the facilitator and the recipient, thus pointing towards ethical problems when dealing with priceless benefits. As a response economics make efforts in pointing out that if the total net benefits are positive, the policy could choose winners to compensate losers. But in real life, the winning side chooses to keep these benefits and thus the ethical problems mentioned above persist.

4.3. We live in uncertain times

In order to allow the comparison between costs and benefits, Cost Benefit Analysis uses figures used in common accounting bookkeeping and these result in a precautionary use of this method. With this comes the following mentality: if one would know the outcomes of probabilities, one could compute weighted averages or expected values on just a hypothesis. But this is not valid, as in reality we have complex details and uncertain results.

However the principle of precautionary use of the Cost Benefit Analysis comes as a suitable alternative when taking into account uncertain elements of the decision-making process. This principle is simply put "better safe than sorry". It is explained as being proactive and making choices based on warnings which are at hand, without the need of having for complete certainty. It also depicts the stages of decision-making which represent measures taken on the basis of worst case scenario, rather than average, possibilities.

4.4. Relative future

In general costs and benefits do not occur at the same time, and also, benefits are considered to last longer than costs. The Cost Benefit Analysis not only allocates monetary values to benefits and costs, but it is also used to convert future amounts into present values.

Discounting, which is multiplying an amount by a discount rate in order to compute present value, is used as a practice in evaluating financial transactions that occur in one lifetime. This method refers to the fact that you can make an investment now, and thus in exchange for your amount you receive a promise of a bigger gain in the future. Or, using someone else's amount you can make a gain by promising to give that sum back with added interest. Thus the use of discounting at prevailing interest rates shows that present and future sums, are equal when measured in present value terms.

This part of the Cost Benefit analysis is sensitive and controversial when taking into account the fact that the use of European funds can have benefits which span over different generations. Thus the definition of discounting no longer applies within its real meaning and instead we find that on very long-term issues discount rates have very low values which is controversial.

4.5. Excessive costs

Regulatory costs generally are overestimated, in advance, several studies have found that preliminary cost estimates are more likely to be too high than too low. In general, economists, tend

to present the fact that even if it is difficult to predict values of costs in the future, it is it is sure that their values are in a continuous decline. However, often enough, one could see that the future predictions of costs, which are used in the Cost Benefit Analysis, and are at the same time the only available estimates, are overestimated because it is considered a strategic move.

Whenever we apply the Cost Benefit Analysis, without a doubt, we have a result of small differences in costs. This in term is interpreted as the sure need of changing policies and it reflects the fact that the sole goal of policies is short-term cost savings and nothing else.

Because, the Cost Benefit Analysis focuses on monetary benefits, it will never be sufficient for decision making when having alternatives between which the cost differences are extremely small. This difference might be explained in other benefits which are outside the scope of Cost Benefit Analysis, thus making it futile in justifying the choice of one alternative over the other.

4.6. Debates over alternatives

Cost Benefit Analysis comes as a solution with clear objectives, focused and transparent computations regarding the advantages and disadvantages of any proposed policy. However, the advocates of this proposal fail to focus on the fact that biases may affect the choice and at the same time people have a different way of interpreting anything.

Cost Benefit Analysis is often limited by the range of alternatives they consider. Thus it becomes hard to use the same set of information in determining what alternative to choose as benefits weigh different in the minds of different economists.

Out of the problems mentioned above, the first three - the central role of inestimable value, implicit assumptions about exchanges, and the importance of uncertainty - are inevitable features of attached to this method, which requires a different approach to decision making in accordance with the best conditions available. The rest of the problems – the exaggeration of costs, future values and debates over alternatives - could theoretically be avoided if the Cost Benefit Analysis was carried out by fully informed, impartial people who have no interest in the outcomes.

5. CONCLUSIONS

As a conclusion we can say that the use of European Union Structural and Cohesion Funds through EU Cohesion Policies has a big influence over the development and acceleration of economic growth in Member States, They are used to aid Member States reach a unified level of economic development and result in a unified Europe.

However in Romania “One of the most urging challenges of the country concerns infrastructure e.g. underdeveloped road, rail, water, air transport system and networks, lack or inter-connectivity as well as the poor quality of drinking water, sewage and waste management, and the lack of environmental awareness”(NSRF 2007:4). In this matter not only should the focus be put in SOP Transport and SOP Environment, but at the same time we need competent specialists to use CBA in order to better allow the use of these funds and increase our absorption level. However, in the real world, these idealized, omniscient, non-political analysts are scarcely found, leading to decision making choices made on the basis of wrong assumptions which in turn resulted in the fact that, after five years after the launch of these programs, Romania was only been able to spend 1% of the funds supporting transport and 2% of those allocated to the environmental infrastructure.

Thus as a suggestion we should focus on reforms of the administration of Structural and Cohesion Funds by using Cost Benefit Analysis better, by trying to avoid the problems mentioned in this article. At the same time one should improve the entire process in terms of receiving and using Structural and Cohesion Funds by its beneficiaries by identifying correctly the true benefits expected from these investment projects.

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