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# Analyses & Opinions

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## Preparing for the absorption of the Structural Funds in Poland Critical overview and recommendations

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- *The work on the successive Polish National Development Plan beyond 2006 must start now. The plan must be fundamentally different from the current document – the National Development Plan for 2004/2006. First of all, it must cover a longer time span and focus on domestic development objectives and circumstances. While it should take into account the evolving EU cohesion policy, it must nevertheless stem from consideration given to Polish strategic interests. It should give a much stronger support to the development of advanced economy and entrepreneurship. It should be based on a domestic structural economic transformation strategy as well as a domestic regional development policy.*
- *The intellectual approach to the issue of the EU funds must change. The experience of EU member-states shows that it is not as important what percentage of the funds is spent (which is what the Polish government is concentrating on) as whether they are spent sensibly - and this should be the focus of planners and decision-makers.*
- *We believe that the system of managing programs financed under the Structural Funds beyond 2006 must be decentralized and simplified. Also, 16 and not just one regional development operating program should be established and provincial authorities should be granted wider executive powers.*
- *The organizing and legislative work must be maximally intensified up to May 2004, i.e. the date on which Poland joins the European Union, so as to best utilize the EU funds granted for 2004/2006. Changes are particularly needed in the system of public finances because without them territorial authorities and the private sector will have difficulties co-financing development programs. The work on IT and financial spending control systems must be accelerated, administration training must be expanded and made more flexible, and fund beneficiaries must be better assisted in preparing good investment projects.*

In 2004/2006, Poland has an opportunity to get financial support to the tune of some €11.3 billion within the framework of the Structural Funds and the Cohesion Fund<sup>1</sup>. The experience of those EU countries that benefit from EU assistance shows that it is very hard to spend all the money granted. However, we must stress that it is not the proportion of the money spent that matters most. Much more important is its sensible spending, focused on making an actual contribution to structural changes and economic development of Poland.

There is a general tendency to look at the use of European resources as a balance of what is paid into and what is gotten out of the EU budget. The threat of Poland being a net payer has forced Polish politicians to attempt changing the image of their role in accession negotiations. At the same time, that threat affects the way Poland is being prepared for the absorption of EU resources. A focus is put on quantity rather than quality. It is, therefore, worth recalling that Greece's problems did not occur because of the insufficient utilization of available assistance funds but because of poor investment decisions.

A wise utilization of the Structural Funds is conditioned, among other things, by a proper preparation of planning documents and investment projects, development of an effective fund management and monitoring system, and re-shaping of the system of public finances with a view to accumulating sufficient project co-financing resources. Still, the most important is a change in the way of thinking about the Structural Funds.

#### **National Development Plan or a list of EU fund expenses?**

The National Development Plan (NDP) is the strategic blueprint for planning domestic and European activities in 2004/2006. This document has several significant limitations. The main one is that, as strategic plans go, its time span of two years is rather short. It is a consequence of the EU budget cycle and the date of Poland joining the EU. While we have no influence over that, the Polish government did have influence over the second limitation –making the National Development Plan strictly dependant on EU investments. A program document of this magnitude should present a cohesive vision of Poland's strategic objectives, particularly those achieved with domestic money. It should not depend solely on European funds and, consequently, on the EU vision of priorities in our country's development.

Similarly to other candidate countries, Poland experiences peculiar developmental circumstances and problems which result from its communist legacy and incomplete economic transformations, and which must be taken into particular consideration when drawing up strategic plans. Otherwise these plans will end up serving for not much more as a backing to applications for EU money.

The adopted NDP development structure was reflected in its preparation process. European Commission officials had much more impact on its content than Polish communities with whom its draft was consulted. A delay in its preparation (it was initially slated for completion by the end of 2001) made it necessary to embark on the development of several planning documents at once, such as operating programs and so-

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<sup>1</sup> *Narodowy Plan Rozwoju 2004-2006* (National Development Plan for 2004/2006), Ministry of Economy, January 2003.

called supplements to operating programs. They should have been developed in sequence rather than parallel. This caused a great deal of misunderstandings and additional work, and also complicated the process of public consultation.

### **It is not the way toward knowledge-based economy**

The main objective of NDP lies in the development of a competitive knowledge-based economy and entrepreneurship. This highly desired direction of the development of Polish economy should funnel the NDP spending into the development of entrepreneurship, introduction of new technologies into Polish economy and investment in human resources.

Meanwhile, a careful study of the National Development Plan shows that close to 60% of available funds will be spent on the development of basic infrastructure, mainly roads and environmental protection solutions. Only a dozen or so percent were earmarked for entrepreneurship support, including only up to 9% for the introduction of advanced technologies. Investment in infrastructure is less troublesome for the public administration than investment in innovation programs, and so it is safe to say that, indeed, Poland will use up a great deal of EU resources. However, as shown by experience gained in other parts of the world, the impact of such investments on economic development is limited. Investment in production based on high technology is much more effective.

### **Absence of stimuli for entrepreneurship development**

We will be able to speak of an effective utilization of the EU funds only when they stimulate local economic network resources. Meanwhile, however, it can be expected that large infrastructure development contracts will be won by more competitive EU enterprises. Already today, most contracts on such projects conducted within the framework of PHARE programs are won by large EU companies.

Another problem lies in the absence of a comprehensive approach to economic development. Since the document in question focuses on spending the EU funds, it lacks domestic small and medium-size enterprise assistance programs. It makes no reference to instruments that stimulate entrepreneurship (investment allowances, tax rate reductions, credit guarantees, regional loan funds, etc.). There is also no indication of sources that would stimulate domestic investment in the National Development Plan. After all, a country's development cannot rely solely on foreign savings.

In the draft of the National Development Plan, some 22% of the funds have been assigned to the development of human resources. They are earmarked primarily for fighting unemployment, especially among social groups particularly disadvantaged on the labor market. As a result, most jobs thus created will be poorly paid and low-skilled. At the same time, only about 5% of the funds are earmarked for professional development of personnel involved in advanced branches of the economy. Studies show that these jobs are precisely the ones that generate the highest developmental stimuli.

### **Overly sectoral arrangement of priorities**

Another problem lies in an overly sectoral arrangement of priorities and execution directions. Since the Polish government is chronically incapable of coordinating implementation measures, this will undoubtedly lead to the application of poorly coordinated sectoral schemes. Therefore, the effect on development will be surely moderate - degraded by the absence of synergy, organizational difficulties and competition for influence between various administrative institutions. The document provides a very blurry description of the extent to which sectoral schemes and the regional development operating program will complement one another.

The amount of resources earmarked for the coverage of project preparation costs is astonishingly low in comparison to other expenses. Document authors seem to assume either a very high efficiency of project handling services and a large number of projects ready for execution or count on the beneficiaries' willingness to engage extremely high sums into project preparation activities. Both assumptions are totally unrealistic.

### **Work on the next National Development Plan must begin now!**

Considering everything that has been said up to this point, there is a need to start the planning work on the successive National Development Plan beyond 2006 as early as possible. The new NDP must be fundamentally different from its predecessor. First of all, it must cover a longer time span and stress domestic objectives and developmental circumstances. It must provide a much stronger support to the development of advanced economy and entrepreneurship. It should be founded on a domestic strategy of structural economic transformations and domestic regional development policy. While it should take into account the evolving EU cohesion policy, it must nevertheless stem from consideration given to Polish strategic interests.

### **Centralized fund management system causes problems**

When discussing the institutional system responsible for spending resources out of the Structural Funds, it needs to be pointed out that 70% of these funds will be managed by individual ministries. In six out of seven operating programs, the entire planning and implementation process will be handled by government administration.

Centralizing management procedures will not necessarily improve the effectiveness of spending EU fund resources. This is associated with an overly sectoral approach to investment programs and, consequently, lack of coordination at the central government level and non-inclusion of local factors in investment planning. In addition, centralized management in Poland carries with itself a gamut of organizational and political problems, which further complicate the effectiveness of investment endeavors.

The climate which accompanies centralization of pre-accession programs in Poland is well illustrated by the organizational disarray among agencies implementing the Phare Economic and Social Cohesion Program. There is no coordination between individual projects nor is their implementation based on strategically selected priorities. Frequent organizational changes are not thought over or consulted properly, and good ideas are put in the same bag as totally inappropriate ones. Their implementation logistics is

limping. In effect, there are serious organizational problems, delays in the execution of individual projects and a growing doubt as to the usefulness of the entire endeavor.

### **Organizational structure of the Integrated Regional Development Operating Program is too complicated**

A special role in spending resources out of the Structural Funds will be reserved for the Integrated Regional Development Operating Program (IRDOP). Compared to other programs, it will be executed with the strongest participation of local self-governments. However, the Ministry of Economy will continue to play a key role. A fundamental impact on centralization of the discussed system was exerted by a decision to establish one (instead of 16) regional development operating program managed precisely by the ministry responsible for regional development.

As a result of adopted organizational procedures, provincial governors will play a more important role in regional development. They will perform principal program management functions at the provincial level, oversee the overall program execution process and participate in the transfer of financial resources from the EU and state budget. Since the provincial governor will have a dominating position in the IRDOP management, he will probably have a significant influence on decisions taken by steering committees, hence on project selection. As for the provincial self-government, it will collect projects and maintain a database of applications for project co-financing out of the Structural Funds. It will also lead the planning work within regional steering committees.

The adopted organizational structure of the discussed program is extraordinarily complicated and may give rise to political tension, thus decreasing the effectiveness of fund resource spending. This is an outcome of two conflicting trends present during the program development phase. On one hand, efforts were made to include territorial self-governments, particularly provincial self-governments vying for position, in the organizational structure, while on the other there was an attempt to satisfy the state administration's aspiration to have as much influence as possible on financial and substantive decisions.

## **Best solutions for the utilization of EU resources in 2004/2006**

What can and must be done right away? How to best use the time before Poland joins the EU in May 2004? What follows is an analysis of various aspects of the system for handling EU fund resources in 2004/2006 which is currently under development and a presentation of recommendations.

### **The system of public finances must change**

The current organization of the Polish system of public finances hinders the long-term planning of structural fund commitments and expenditures as well as domestic co-financing of projects. The system of public finances does not guarantee that the planned amounts will be actually allocated into the implementation of objectives of the National Development Plan for the next few years. There is a need for legislative changes,

particularly for a directive of the Ministers' Council on how to monitor, assess and reporting on projects and programs financed out of the EU funds.

It is also necessary to change the structure of public spending, mainly by transferring a portion of earmarked resources to territorial self-governments. Let us remember that the current government has suggested such solutions in its electoral program. The draft of the reform of public finances drawn up by Deputy Premier Kołodko calls for a larger share of income tax revenues going to territorial self-governments in exchange for elimination of state subsidies. This may not be sufficient to ensure a domestic co-financing of EU investments.

The smallest administrative units (*gmina*) are considered better prepared to absorb resources than other territorial self-governments. Contrary to districts and provinces, they have their own resources to execute investment projects. However, their potential involvement in EU projects will depend on the adjustment of current investment plans and reduction of certain current expenses. It should be remembered that the territorial self-government share in co-financing projects executed with the assistance of the Structural Funds is estimated at close to EURO 1 billion.

One should bear in mind the cost of project preparation (feasibility studies, environmental assessments, land purchase, technical and construction designs) as well as the need to contract commercial credits for certain EU projects. This may be a problem, particularly in case of *gminas*, which operate on very small budgets. In turn, large towns and metropolitan agglomerations are heavily indebted, which may also seriously limit their investment capabilities. Those reserves that territorial self-governments had in the form of communal property have been severely depleted. Consequently, it seems that a proper level of financing structural projects will need to rely on public money. Some groups suggest raising the statutory self-government indebtedness ceiling from 60% to 70% of annual revenues, but that is not a good solution.

Finance Ministry officials have offered PLN 6 billion in state guarantees to co-financing projects executed with the assistance of the EU funds. In addition, the central government plans to set aside a special reserve to subsidize certain local self-government projects, particularly in case of those self-governments that find themselves in a dire financial situation.

Such initiatives are extremely necessary. However, they must be worked out in every detail and appropriate criteria must be developed for granting public assistance to EU-backed projects. The application of public aid instruments should go hand in hand with restructuring provincial contracts so as to maximize investments that are of a truly pro-development nature and, at the same time, provide for domestic co-financing of EU projects. In addition, government plans should include the proposal to set aside a fund reserve earmarked for technical costs of preparing project documentation. Furthermore, a comprehensive solution must be found to the issue of improving the system of public finances, including its real rather than feigned decentralization. The most important is to raise the amount of investment funds available to provincial self-governments.

The central government must also find additional sources of domestic financing of NDP investments. Permitting Open Investment Funds to engage resources in NDP programs is one good solution. The program of repairing public finances must include investment in Polish enterprises and territorial self-governments.

### **There must be more support of entrepreneurship**

The central government expects entrepreneurs to contribute close to EURO 2 billion to EU project co-financing. This may turn out to be overly optimistic, the more so since financial institutions are not sufficiently interested in crediting such investments.

More than 90% of Polish businesses are small, employing nine people or less. Excessive dispersal of enterprises with insufficient equity, credit that is difficult to get and very expensive, as well as hold-ups in payments down the contractor chain do not favor investment and innovation financing. Let us remember that the current investment indicator is the lowest in 12 years and that 90% of Polish companies invest in development only out of their profits.

Phare pre-accession programs are an interesting example of entrepreneurship support with the EU funds. This refers especially to the development of small and medium-size enterprises (SME) under the Phare Economic and Social Cohesion Program. Several factors are responsible for the difficulties experienced by that program, particularly in provinces located along the so-called "eastern wall". First of all, entrepreneurship in those areas is very poorly developed. One can hardly expect these frail businesses to have sufficient resources in equity or commercial credits to be able to make significant investments into co-financing EU projects. Consequently, a serious drawback of that Phare program rested in the unavailability of a preferential corporate loan granting system. Moreover, in most provinces in eastern Poland commercial financial institutions are few and those that exist are relatively weak. Consequently, they do not constitute a suitable base for the Phare program.

There is an urgent need to establish financial instruments that will assist entrepreneurs in their participation in EU programs, particularly credits granted on preferential terms by state banks such as Bank Gospodarstwa Krajowego or PKO BP. Also, there should be more support for provincial financial institutions - investment funds, credit guarantee funds, etc. Moreover, regional development agencies should be closer linked to provincial self-governments. A possible scenario would be to transfer central government entrepreneurship development funds to regional self-governments and then have them managed by these agencies.

### **Training of UE fund management personnel must be accelerated and improved**

There is a need for administrative backing that would be able to handle the burden of managing EU fund absorption. The Polish civil service system is very poorly developed. There is very little training of public servants in handling challenges associated with absorption of the EU funds. An additional problem rests in the low wages paid to civil servants, which make experienced specialists leave the administration. It should be expected that after Poland joins the EU even more personnel will leave the Polish civil service for EU institutions. Training that is offered is often ill adapted to the needs. All these problems apply equally to the situation within the central government and local administration.

The central government is planning to add some 600 positions to state institutions which handle the EU funds and makes approximately PLN 11.5 million available for hiring new

civil servants. However, the price of hiring additional personnel on the provincial level will have to be paid by provincial self-governments. The central government is also planning to reorganize central and provincial administration institutions and carry out a civil service training campaign for provincial marshal's office personnel and future EU fund beneficiaries.

### **Make up for delays in the application of a computerized monitoring system**

The Computerized Monitoring and Control System (CMCS) must be operational one year prior to the absorption of the Structural Funds. Its development has fallen considerably behind the government schedule. The principal cause for this lies in the absence of coordination and proper inter-ministerial collaboration. Individual ministries have also fallen behind schedule in the development of their own systems of monitoring, assessing and controlling operating programs and structural funds. The absence of legislation governing such systems is an additional problem.

### **Absence of good investment projects**

The Ministry of Economy has set up a database of potential projects that could be developed within the framework of IRDOP and the Cohesion Fund. The database contains projects registered with provincial marshal's offices. So far, some 600 projects have been entered into the database, but the Ministry of Economy believes that only one third has been properly prepared. Potential beneficiaries of the EU fund assistance must deal with the additional problem of not knowing the ultimate shape of the National Development Plan. For example, they still do not know what information will be required in the structural fund subsidy application. This hinders the project preparation work of territorial self-government units.

At the same time, the central government shows no inventiveness as concerns streamlining the project preparation process, for example with respect to simplifying certain investment regulations (such as issuing building permits), creating a fund to subsidize documentation development costs, changing long-term planning regulations, etc.

From the viewpoint of ensuring an appropriate absorption of the EU funds, the main problem lies in the preparation of high-quality investment projects. Project development requires not only time (sometimes even more than a year), documentation preparation resources (even as much as 5% of the project value) and administrative skills. For a project to be valuable, it must be based on a good idea.

An examination of the submitted projects shows that many potential beneficiaries lack administrative imagination and long-term planning skills. In particular, there is a deficiency of sequential thinking abilities and development objective selection skills. Local strategies, often developed just for show, are not helpful in specifying developmental priorities. The practice of filling out Phare project applications shows that what counts more is the wish to spend the EU funds for whatever purpose rather than use them sensibly and to the benefit of the local interests. This is why a successful application of the Structural Funds depends before all else on changing this way of thinking both among central government decision-makers and regional and local politicians.

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Organizational and legislative changes suggested herein must be implemented before May 2004. At the same time, the work on preparing a system for handling the EU funds in 2007-2013 must be started as quickly as possible. Before all else, there is a need to decentralize and simplify the program management system, including the establishment of 16 regional development operating programs rather than only one.

The work on the successive plan for Poland's development beyond 2006 must begin as soon as possible. This plan must be fundamentally different from its predecessor. It must give much more support to the development of advanced economy and entrepreneurship. It ought to be based on a domestic strategy of structural economic transformations and a domestic regional development policy. While the plan should take into consideration the evolving EU cohesion policy, it must nevertheless stem from consideration given to Polish strategic interests.

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