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Estonian Local Government Absorption Capacity of European Union Structural Funds

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Abstract

European Union (EU) regional policy has played a great role in the transition economies of Central and Eastern European Countries (CEEC). However, the effective implementation of EU regional policy requires that local and regional governance systems in Member States are compatible with EU practice and regulatory norms (e.g. partnership) emphasising the importance of the well-performing sub-national government. The article discusses Estonian local governments' absorption capacity problems in the EU Structural Funds by investigating the main factors restricting them from using the aid. The article is based on a survey among Estonian local governments conducted in 2005. This survey was also supported by meetings of the representatives of three Estonian counties – Lääne-Viru, Pärnu and Jõgeva – and the City of Tartu. The results show that Estonian local governments regard Structural Funds as one of the most important instruments in their socio-economic development while the capacity to absorb the funds is limited due to the low administrative and financial capacity of the local government level.

Key Words: European Union regional policy, Structural Funds, absorption capacity, local government, sub-national government.

1. Introduction

Alongside the single market, economic and monetary union, a fundamental objective of the EU is cohesion, the reduction of economic and social disparities between richer and poorer regions within the Union. To ensure that this goal is reached, the instrument of Structural Funds was introduced in the context of EU regional policy. By now Structural Funds have become an important facilitator for regional sustainable development throughout the EU. In fact, "Structural Funds are the most important regional policy instruments at Member State level" (Martin 1999, 101).

In 1993, the European summit of the EU gathered in Copenhagen and made the historical decision to allow CEEC to become EU members. The following enlargement in 2004 has obviously not been an easy process: the new Member States still face a wide range of internal regional problems and are economically and socially behind most of the old EU Member States. Upon the enlargement, the eight poorest new Member States, including Estonia, had a per-capita gross domestic product (GDP) approximately 40% of the average in the EU25, and the number of regions with per-capita income less than 75% of the EU average nearly doubled with the enlargement (European Commission 2003, 2). This has created difficulties for the whole Union to achieve the objectives of overall cohesion. Moreover, it was acknowledged that "cohesion policy will be successful only if it involves all actors in an active partnership to identify challenges and define strategies" (ibid., 22). Therefore, one of the EU's main concerns over integration was the issue of how best to organise regional and local governments in cohesion policy as the administrative capacity of these levels was seen as critical for the success of the whole enlargement project (Hughes, Sasse and Gordon 2001, 9).

With the accession, approximately 371 million Euros from Structural Funds were allocated for Estonia to support the development of human resources, enterprise development, agriculture and rural life and for the regional development. An additional 307 million Euros came from the Cohesion Fund to support large infrastructure investments like transport and environment infrastructure. By now, the first Structural Funds programming period, 2004-2006, has ended and the next financing period, 2007-2013, is in the middle of its run. In light of the overall economic crisis and the extreme steps and cuts taken in planning the state budget in Estonia in 2009 and for 2010, EU facilities through the Structural Funds have become even more important. At the same time recent economic developments in the world (e.g. decreased economic growth, boosting unemployment) pose significant challenges also for regional policies of the EU Member States. This is very relevant for Estonia as well as the absorption capacity at the state level but more importantly at the sub-national level[1] can seriously hinder the adequate use of Structural Funds. The evaluation of the impacts of the Structural Funds in Estonia so far is not yet complete, which makes it impossible to draw conclusions about the policy's success or failure. The overall economic growth of Estonia at the beginning of the 2004-2006 financing period has indeed been reported to be satisfactory – according to the 2005 data, its per-capita GDP was 60.1% of the EU25 average and estimates for 2008 were almost 75% of the EU average (National Strategic Reference Framework 2007-2013, 21).[2] Still, Estonia has considerable disparities within its territory which is also emphasised as the common problem in the EU regional policy in general. The European Commission has reported that "disparities between regions in different countries have continued to fall but have grown within Member States" (European Commission 2003, 8). In this respect, the administrative and financial capacity of local government units is one of the key challenges for Estonia as 3.4 billion Euros from the Structural Funds need to be absorbed in the period 2007-2013, including 981 million

1 Refers to all territorial definitions below the national state – regions, local, interlocal and interregional collectivities. As Estonia is a unitary state with a one-tier local government system, "sub-national" in this article mainly refers to the local government level.

2 According to Eurostat, the actual figure for 2008 was 67.4% of the EU27 average.

Euros[3] for regional development (National Strategic Reference Framework 2007-2013, 134). This indicates the need to map clearly the sources of absorption capacity problems in the municipalities in order to find measures to overcome these obstacles.

Correspondingly, the aim of the article is to explore the Estonian local governments' absorption capacity of Structural Funds, the main problems restricting local governments from using this instrument as well as the factors that may influence the Structural Funds absorption capacity of the Estonian local governments? The analysis is based on a survey conducted in 2005 among Estonian local governments in order to find out their experiences with the Structural Funds. In the first part of the article, theoretical explanations of the EU regional policy and absorption capacity of Structural Funds are discussed. The second part of the article focuses on the findings of the empirical survey. Consequently, the article brings out the main absorption capacity problems in the EU Structural Funds among the Estonian local governments and relates the findings to the broader debate on the subject.

2. European Union regional policy at Member-State level

EU regional policy is a genuinely shared policy based on financial solidarity. It permits the transfer of over 35% of the Union's budget, which comes mainly from the richest Member States, to the least favoured regions through the Structural Funds. Still, many authors who have studied the topic have indicated that despite large regional policy expenditures, regional disparities in Europe have not narrowed substantially over the last two decades and by some measures have even widened (De Rynck and McAleavey 2001, Rodriguez-Pose and Fratesi 2004). Studies have also shown that the regional mobilisation effect induced by the EU is differentiated, depending on the power resources of regions in the different national contexts of federal/regionalised or unitary Member States (Benz and Eberlein 1999, Brusis 2002), or on the existence of regional policy communities advocating an entrepreneurial approach of regional development (Brusis 2002, 534, Kovács 2009). The implementation of the principles of EU regional policy in each Member State, therefore, depends on the institutional and structural edifice, central-local relations and state-society relations, local/regional embeddedness, social capital and the political culture in each country (Getimis 2003, 78).

Nevertheless, EU regional policy as it has evolved over the four decades has left a significant mark on the domestic regional politics and policy. Due to the EU integration, new opportunities have arisen for local governments (De Rooij 2002, Zerbinati 2004). In order to identify the impact of the EU on the municipalities one needs to evaluate the "absorption" of EU policy or EU funds which comes top-down from the EU to the municipalities. Zerbinati (2004, 1000) adds that some researchers named these changes "Europeanisation", and in recent years, a huge quantity of research has focused on the role of sub-national governments in European affairs. Still, while the literature has indicated the existence of a process of Europeanisation within the nation-state, the relevance of this very general concept of "Europeanisation

[3] ERF funding in the Operational Programme for the Development of the Living Environment.

as domestic adaptation" in the local-level context still remains vague (Marshall 2005, 671). Moreover, there is a decent amount of research literature on regional and local governance in Western Europe (e.g. Goldsmith and Klausen 1997) and the impact of the EU on these levels, but much less has been written about this in the CEEC, and still, little is known about the institutional capacity, practices and attitudes of the elites at this level (Hughes, Sasse and Gordon 2001, 4). Nevertheless, the sub-national arena of regional and local politics is of key importance in CEEC, too. The impact of Structural Funds on the regional and local level often depends on the strength of the sub-national government and its varying strategies and capacities (Bullmann 2001, 17). However, the main problem of the 2004 accession countries is that in the spirit of regionalism, they were not able to decentralise their public power system as in most cases, the central governments are still the driving forces of decentralisation (see also Kovács 2009, 55). Estonia, too, has adopted a relatively centralised arrangement of regional policy, with the Ministry of Finance playing the key role in coordinating and managing the Structural Funds, and no significant changes in territorial governance have been adopted in light of EU regional policy principles (Kettunen and Kungla 2005, 373).[4]

3. Absorption capacity of Structural Funds at the local government level

In the area of Structural Funds, the EU is not a simple subsidising authority. Grants are allocated to projects within the framework of a programme, subject to specific conditions regarding the nature of expenditures eligible for a grant from a Structural Fund, the management of funds and the ability to monitor operations and verify their execution (European Council 1999). This means that the Member States have to have the ability to establish convincing programmes, involving local and regional authorities as well as social and economic partners. In addition, potential beneficiaries (in a large part of the cases local and regional authorities) should be able to submit applicable projects. Therefore, not only the absorption capacity of the central government institutions is important, but also the capacity to apply for these, in many cases centrally managed and controlled, funds from the regional (if applicable) and local government levels needs to be considered.

Even though recent years have shown an increase in literature on the EU regional-policy impact on the sub-national level of the new Member States, a review of academic literature indicates the absence of a conceptual framework to comprehensively assess the issue of absorption problems relating to Structural Funds. According

4 The impact of the EU regional policy on the empowerment of sub-national levels has been thoroughly discussed in the multi-level governance (MLG) discourse advocated by Gary Marks (1993) and his colleagues. In spite of the originally overly positive MLG thesis in terms of sub-national mobilisation in domestic and EU policy-making, studies that followed to investigate the applicability of this concept show that the impact of EU cohesion policy on the territorial politics of Member States as well as the empowerment on the sub-national levels varies considerably, and the emergence of MLG arrangements is dependent on many intervening variables like the pre-existing territorial structure of the state and the legal-constitutional position of sub-national governments, which determine their available resources for mobilisation. Good resources for this discussion are provided by Marks (1993), Hooghe (1996) and more critical approaches by Jeffery (2000), Jordan (2001) and Bache (1998, 2008).

to Horvat (2004, 4) one reason for this may be that the EU's regional policy is still a relatively new field for investigation, especially if one looks to assess the impact of Structural Funds on long-term convergence or to measure the influence of absorption problems. In addition, Verheijen (2002, 247) points out that the "administrative capacity" (including absorption capacity) of candidate states has not been a key issue before the EU enlargement in 2004 as the states that acceded previously (e.g. 1995 enlargement with Austria, Finland and Sweden) traditionally had well-functioning administrative systems and partial experience of working inside the EU political system, for example through the European Economic Area. Therefore, Structural Funds absorption-capacity definitions are usually given based on different evaluation studies and reports prepared and published by the European Commission or by the new EU Member States (Horvat 2004, 5).

The absorption capacity stands for the degree to which a country is able to effectively and efficiently spend the financial resources from the Structural Funds to make a contribution to economic and social cohesion (Boeckhout et al. 2002, 2). In order to do this, it is necessary, on the one hand, for the institutional system created by the particular state to have an absorption capacity in order to manage the funds at issue and, on the other hand, an absorption capacity from the beneficiaries whom these funds address. Therefore, one could speak of two distinct characteristics, namely the absorption capacity on the supply side (of funds) and the absorption capacity on the demand side (Šumpíková, Pavel and Klazar 2004). The latter is related to the capacities of potential beneficiaries to design projects and to finance them and will be concentrated on hereafter.

Furthermore, absorption capacity can be determined by three main factors (Horvat 2004, Boeckhout et al. 2002, Šumpíková, Pavel and Klazar 2004): macro-economic absorption capacity,[5] administrative absorption capacity and financial absorption capacity. Administrative absorption capacity can be defined as the ability and skill of central, regional and local authorities to prepare suitable plans, programmes and projects in due time, to decide on programmes and projects, to arrange the coordination among principal partners, to cope with the administrative and reporting requirements, and to finance and supervise implementation properly, avoiding irregularities as far as possible (Horvat 2004, Šumpíková, Pavel and Klazar 2004). The question of administrative capacity regarding the use of Structural Funds in CEEC Member States emerged when these countries revealed differences in their use of pre-accession instruments, especially the Phare funds (Martens 2001). With the accession, the regional and local levels in CEEC became the main beneficiaries of the Structural Funds, thus, there are obvious reasons why the EU has been emphasising that the new Member States should demonstrate that they have the administrative capacity to implement its policies (Kungla 2002, 20), including the capacity of the sub-national level to absorb the new opportunities introduced by the EU.

Financial absorption capacity stands for the capacity of central, regional and local authorities (dependent on the territorial set-up of the country) to co-finance pro-

[5] Can be defined and measured in terms of GDP levels to the allocated Structural Funds. The focus of the article is only on the capacity of the demand side, therefore macro-economic absorption capacity will not be analysed in detail.

grammes and projects assisted by the EU, to plan and guarantee these domestic contributions in multi-annual budgets and to collect them from the various partners involved in a project or programme (Horvat 2004, Šumpíková, Pavel and Klazar 2004). Most probably, the financial absorption capacity of local governments takes the central position when looking at their Structural Funds absorption capacity. Namely, one of the major obstacles hindering the development of regional policies in the CEEC concerning the integration into the EU has obviously been the lack of finances (Bollen 1997). One of the criteria to absorb the Structural Funds has been the ability to match funds, as a significant amount of co-financing of projects (15-20%) from regional, local or national budgets is required according to the Structural Funds regulations.

In addition, De Rooij (2002) identified the EU influence on local authorities. Three dimensions can be highlighted here. First, the "absorption" of the EU policy or EU funds, which comes top-down from the EU to the municipalities: the implementation of the EU legislation, meeting the criteria for money from the EU funds (indicated by the term "eligibility"), and receiving money from the EU funds. Second, "proactive attempts" to influence the EU policy and promote interests which go bottom-up from the municipalities to the EU: attempts to influence the EU legislation, to influence the distribution of EU funds, lobby and develop contacts with national and European politicians. Third, the "organisational adaptation" which is connected to "absorption" and to "proactive attempts": new departments, new officials and new items on the agenda of the local council. (De Rooij 2002, 452-453).

4. Local governments in the administrative system of Estonia

In accordance with the general principles of local government laid down in the Constitution of the Republic of Estonia (Parliament of Estonia 1992, Art. 154 section 1 and Art. 155 section 1) there are 33 cities and 193 rural municipalities in the local government system of Estonia (Ministry of Internal Affairs). There is no directly elected representation of people on the regional level. Estonia is divided into 15 counties, governed by county governors; however, they cannot be seen as administrative levels, as by law (Parliament of Estonia 1995), they are subordinated to the central government. Therefore, in general terms, Estonia is a country with a centralised administration.

The 226 Estonian local governments vary to a great extent in their size and their ability to fulfil their functions. Many characteristics of the local government system in Estonia have been influenced by the Soviet heritage and changes in administrative systems during the transition process. Local governments are not financially independent from the state; their role and tasks in society are still unclear, and the division of the tasks between the state and the municipalities varies among concrete cases (Tõnnisson 2004, 2006). Furthermore, local governments often do not have enough skills and knowledge to develop strategies for the best possible usage of the resources and to improve the existing state of affairs (Tõnnisson 2006, 12). The latter has led to the situation where most municipalities deal with their own everyday problems, having no interest and resources to deal with their long-term strategies. Factors that may influence the overall Structural Funds absorption capacity of the Estonian sub-national level will be more thoroughly addressed below. Overall, the wide internal regional disparities in Estonia indicate the need for a strong, participative and effective regional policy. There have been several attempts to tackle the efficiency problems of the fragmented local government system by reducing the number of local government units. Thus far all such proposals have been watered down largely because of the central government politicians' fears of losing support in the localities concerned and the overall complexity of the issue (Kettunen and Kungla 2005, 363). Moreover, reducing only the number of authorities may actually not be the best solution for improving the local governments' absorption capacity problems as will be seen in further discussion.

5. Research methods

The article is based on research conducted by the author among Estonian local governments in 2005 in cooperation with Innopolis Consulting Ltd. and SEB Eesti Ühispank. A survey was conducted bearing in mind that the preparations for the National Strategic Reference Framework 2007-2013[6] had been started, which meant that measures for using the Structural Funds facilities were about to be decided. The questionnaire was sent to all local authorities in Estonia[7] and received 84 responses, indicating a representativeness of 35%. All 15 counties in Estonia were represented. Most of the responding local authorities were small (in 51% of the cases with population of 1,000-5,000) and mainly from counties which are less developed and face more difficulties in regional development[8] (e.g. Põlva, where 71% of the municipalities in the county responded to the questionnaire and Jõgeva County with a response rate of 62%).

Additional meetings with the heads of the municipalities were organised at the end of 2005 and at the beginning of 2006. Three counties were selected for this purpose based on the fact that their response rate in terms of number of municipalities remained rather limited in the survey or according to their rather low socio-economic conditions – Lääne-Viru, Pärnu and Jõgeva County. In addition, a meeting with the Vice-Mayoress of Tartu City was conducted bearing in mind that Tartu is the second largest and developed city in Estonia, also active in absorbing EU Structural Funds. The main purpose of these meetings was to discuss the subjects presented in the empirical survey, as well as to investigate how local governments evaluate their participation and involvement in the planning process of regional development programmes and in the composition of the strategy for absorbing the Structural Funds in the period 2007-2013.

This research method inevitably places the whole research question of this article within certain methodological limits. As addressed above, it may be still

6 Planning EU Structural Funds support for the financing period 2007-2013 has been organised in parallel with planning the Estonian National Budget Strategy, making it possible to design EU support together with Estonian national grant schemes. Estonia incorporated specific operational programmes of different sector policies to this planning process of the Structural Funds distribution (see National Strategic Reference Framework 2007-2013). These operational programmes determine the exact eligible actions and the amounts of funding from Structural Funds for the period 2007-2013.

7 241 local governments received the questionnaire, which was the official number of local authorities in Estonia in 2005. Since the local government elections on 18 October 2009, there have been 226 local governments in Estonia.

8 According to the Estonian Regional Development Strategy 2005-2015 and its mid-term reviews.

quite early to assess the impact of the EU Structural Funds in Estonia as well as measure the absorption capacity of the local government level in more objective terms. This study remains qualitative in its essence and is based on the "perceived" local government absorption capacity as self-assessed by responding civil servants drawing on their experiences with Structural Funds in their localities. Nevertheless, the author is convinced that the results of this study serve as a necessary basis for leading further research on assessing the impact of the EU regional policy in Estonia and the capacities of the sub-national level to respond to this opportunity structure.

6. Research findings and discussion

6.1 Human resources and organisational adaptation

The administration of the EU Structural Funds has been determined primarily according to the existing national structures of the Member States. Some representatives of local authorities, notably objective 1 regions (areas lagging behind in their development where the GDP is below 75% of the EU average),[9] have admitted that the implementation of Structural Fund policies required skills and competencies that exceeded their resources (Wishlade 1996, 44-45). Furthermore, the financial situation of these regions was often such that they could not compete with the private sector to attract staff with the requisite skills and technical expertise (Ibid.). The latter seems to have support in Estonia as well. Estonia is a small state with a limited pool of specialist knowledge, and there is frequently a lack of resources (financial, time, people) for high-quality development activities in the municipalities (see also Randma-Liiv and Viks 2005, 75). In general, the systematic development process in the municipalities is missing especially due to the lack of human resources. Forty-four per cent of the respondents of the survey had to admit that they did not have staff with the competence to work on EU issues, development activities and applying for funds (Innopolis 2005, 15). The management of successful projects has to be done in addition to their everyday work, which in turn means a heavy workload as well as sporadically a poor quality of applications and many problems in managing the projects afterwards. Thirty per cent of the respondents admitted that they have established a position in the organisational structure for dealing with EU matters but in spite of that, very many services related to specific preparations (e.g. feasibility studies, construction projects etc.) have still been outsourced due to the lack of specialist skills. The responding local governments also estimate that 24.4 % of all the reported financial needs from Structural Funds under so-called "soft projects"[10] would be directed to the development of human resources, making this their first funding priority under this category (Innopolis 2005, 35). This indicates that the administrative absorption capacity of the Estonian municipalities in the EU Structural Funds is relatively weak.

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9 The 2007-2013 Convergence Objective addresses these areas. Considering the distribution of Structural Funds Estonia as a whole belongs under the EU Convergence Objective.

10 Respondents had to differentiate between infrastructure investment projects in different fields and other kinds of "soft projects" like training, preparations for larger investments, studies, cooperation etc. (see Innopolis 2005, 16-23).

The lack of qualified people in very many municipalities in Estonia puts an overwhelming emphasis on capable individuals in the municipalities. Research conducted by the Estonian Ministry of Internal Affairs together with the University of Tartu[11] indicated that frequently, the sequence of development activities in the local governments is dependent on a particular person, and huge problems may arise when this person leaves the job. This also coincides with the study of the role of public leaders in regional economic development conducted by Raagmaa (2001), who claimed that when public and civic structures are weak, the leader's role in defining goals, initiating activities via organisation and raising funds will be crucial. Therefore, in certain cases, due to the lack of a single active and enthusiastic leader personality in the municipality, several funding possibilities from the Structural Funds may be left unused. Just 11% of the municipalities had created the position the main task of which was to initiate development projects and prepare them for funding as well as to manage those projects afterwards. From the meetings with the heads of the municipalities from Jõgeva County, it became apparent that frequently, all the work is on the shoulders of one person (mainly the head of the municipality or a special project manager) and his/her leaving was seen as a real threat to the development activities in the municipality related to Structural Funds. In some cases (Jõgeva County, Pärnu County), active non-governmental organisations' representatives had been triggers for almost all regional development projects without even being financially rewarded for their efforts, allowing the assumption that the role of "leaders" remains relevant especially in economic peripheries.

However, in smaller municipalities, where the need to apply for funds may be short-term and not constant, the decision to hire a full-time specialist may not even be the best solution. As stated by Randma (2001, 46), small states like Estonia need most of the basic types of specialist personnel required in large states, but they need them in smaller numbers. On the one hand, a small number of people have to cope with a large number of tasks. On the other hand, a specialist area can be so narrow that it does not offer enough work for a full-time job (ibid.). The solution can be project-based employees or consultants who are competent and are equipped with necessary experiences and who have the skills to apply for the EU funds. To provide a similar case, the same tendency appeared in the study conducted by Zerbinati (2004) in England and Italy. In English cases, most of the studied local governments had employed a new type of professional manager with expertise in EU funding (a clear understanding of the rules) and skills to improve the absorption of EU funding in the local area. Since they were smaller in size, the Italian local councils, instead, relied on training the existing staff and employing professionals on a consultancy basis. No clear understanding of the rules of applying for EU funds existed in the Italian case, and the managers often referred to an element of "luck" in justifying their successful bids. Research conducted in the Czech Republic in order to explore its capacity to absorb the EU Structural Funds found that regarding the municipalities, there was significant distinction between the approach of small municipalities and big cities (Šumpíková, Pavel and Klazar 2004). While big cities often have highly experienced staff, small municipalities rely on external consultancy (ibid.).

[11] Ministry of Internal Affairs and University of Tartu 2001.

This seems to be the case in Estonia, as additional meetings with the heads of the municipalities indicated that those in the cities and bigger municipalities (e.g. Pärnu, Tartu, Rakvere and Jõgeva City) have units in their organisational structures which deal with the development projects every day and are competent in the EU funding process. Vice versa, smaller and more peripheral municipalities (e.g. Mustvee City, Saare and Häädemeeste municipality) indicated that mostly the head of the local government has to do everything; from planning to implementing projects, which means that often he or she even writes the applications. Often consultants cannot be used because of the lack of financial resources, and units cannot be created for the same reasons.

It is evident that the accession to the EU and the availability of Structural Funds has opened a new opportunity structure for local governments in Estonia. Only three per cent of the responding municipalities admitted that they do not need to apply for Structural Funds for their development activities (see figure 1). In spite of this, the impact of the EU Structural Funds on the organisational structures and on hiring specific officials to work in the municipalities on EU matters is not so evident yet, mainly due to the lack of proper human resources as well as the relatively high costs related to this kind of organisational adaptation.

6.2 Influence of the central government's "administrative capacity"

The main reasons why Estonian local authorities do not apply or have not yet applied for Structural Funds are given in figure 1. In 19% of the cases, the reason has been the high administrative burden of applying for funds. This is strongly related to the previous discussion of the lack of competent officials in the municipalities. Rigid rules need to be followed, and a lot of preparation work is done while applying for funding. Also the project accountancy done afterwards is complicated. The survey brought out that while there are problems with the human resources who would have sufficient time and skills to deal with EU affairs, the overwhelming red tape surrounding the bidding process and project management from the state side hinders the process even more.

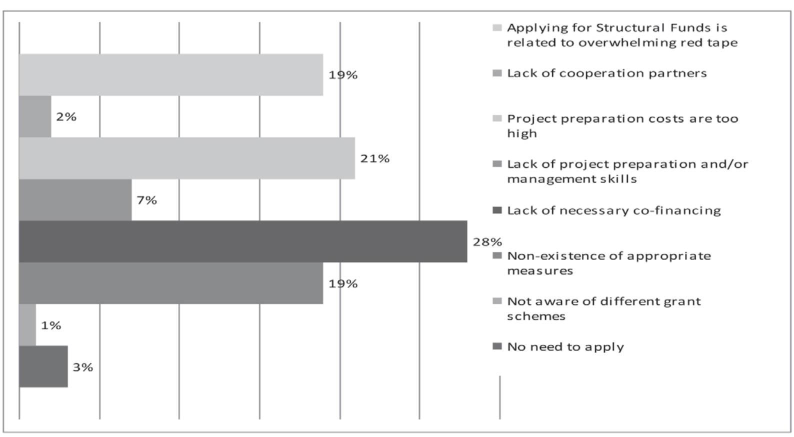
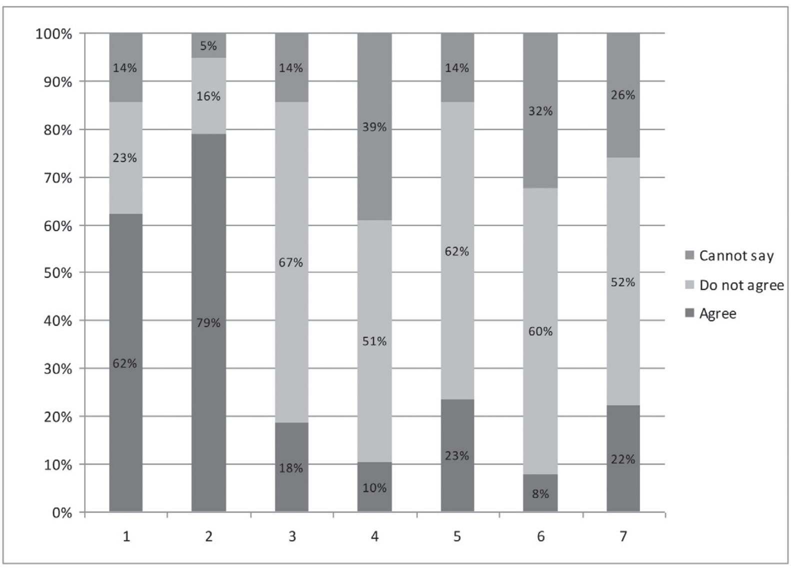


Figure 1. **Reasons for not applying for Structural Funds grants**

Another factor from the survey supporting this argument was also evident. Local governments were asked about their satisfaction with information about the Structural Funds' possibilities. Even though most of them (84%) were satisfied with the overall information about the funds, 16% regarded the flow of information in the process of application formulation by the Implementing Agency as insufficient, often late and frequently incompetent referring to problems with information quality (Innopolis 2005, 25). Moreover, figure 2 below shows how respondents assessed seven statements and whether they agreed with those. Figure 2 illustrates that in the case of almost every statement (except the first and the second point in figure 2) over a half of the respondents do not agree. This indicates the lack of administrative smoothness of the application processes of Structural Funds. These investigations signal that there are still problems in the administrative capacity on the central government's side and in that case it may even be too optimistic to hope that the local level will have the necessary capacity to effectively apply for and use Structural Funds for their development activities.



1. Administrative requirements for applications are well presented and clear.
2. Regulations and guidelines of different programmes are of good help inpreparing applications.
3. Imposed requirements on application procedures are logical and easily implemented.
4. Evaluation and assessment procedure of the applications is transparent and fair.
5. Feedback to applicants is sufficient and justified.
6. Making changes to projects in their implementation process is easy.
7. Project accounting for the Implementing Agency is easy.

Figure 2. **Previous experiences with project application and implementation procedures (% of respondents)**

6.3 Proactive attempts

The agreed amount from Structural Funds for the period 2004-2006 has been transferred from the European Commission to the Estonian government, which has subsequently distributed the money to applicants which meet the criteria (eligibility, procedural criteria and co-financing). The European Commission decides whether municipalities are eligible and meet the procedural criteria, while the Estonian government makes the more political decision as to which projects ultimately receive the money, and how much. This generates opportunities for influencing and lobby processes between sub-national and national government (see also De Rooij 2002, 455). Peter John (2000, 879) states that regional policy is a classic example of rent-seeking, whereby interest-groups seek to benefit from public funds. In the EU context one level where the rent-seeking can appear is between the central government and local governments. Since the national government is the mediator (if not allocator) of Structural Funds, the local governments engage in lobbying to obtain the funds or the necessary co-financing parts (Kálmán 2002, 5-6).

According to the survey, indicators supporting the fact that some local governments are more proactive in lobbying for EU funds than others are also evident. In figure 2 above, respondents were asked to evaluate their satisfaction with the application process and further project-management procedures of Structural Funds projects. Accordingly, the evaluation process of the applications is often seen as unfair (point four in figure 2). Almost 51% of the respondents think that the process is unfair and 39% have not enough knowledge of this matter. These numbers were explained by several respondents in an open answer box who indicated that in distributing funds, acquaintances matter the most, and ultimately those with heavy lobby work and the right contacts receive the money in most cases. The fact that 39% cannot answer this question may indicate that they do not know the process and are not very proactive themselves. Several comments expressed in the survey as well as elaborated in the meetings with the heads of the municipalities indicated the overall agreement that bigger and stronger municipalities with better resources are better off when applying for EU funds. Unorganised actors on the sub-national level are often unable to come onto the policy scene. It has been found that success in initiating and driving the European funding process involves pro-activeness, innovation, risk-taking, leadership and creativity, a combination of attributes associated with entrepreneurial behaviour (Zerbinati and Soutaris 2005, 48). This kind of behaviour seems to be missing in quite a remarkable number of municipalities in Estonia (see also Tõnnisson 2004, 2006); however, the evidence for this statement should be handled more deeply, apparently with a specific study.

Overall, it appears that the administrative capacity of the Estonian local governments to absorb EU Structural Funds is quite problematic. The lack of qualified human resources is the central reason for this. On the one hand, the current personnel, especially of many rural municipalities, still lacks the qualification for dealing with the EU Structural Funds issues. On the other hand, the small size of the country as well as the great number of rural municipalities act as a restriction in hiring the needed officials. Therefore, not much evidence of organisational adaptation as well as the ability to lobby for the funds can be indicated according to the research. Even though assumptions for weak proactive actions for absorbing EU Funds apparently are relevant, some rent-seeking behaviour still seems to be present on the local level for competing for EU funds, and seemingly smaller and weaker local governments are not able to compete here with the larger ones that possess more necessary resources (people, skills, money, information, contacts etc.).

6.4 Matching funds from local level

In most European countries, local governments have the general power to undertake any activities (unless specifically forbidden or already undertaken by other bodies) which they consider to be in the local public interest. The ability of local governments to provide local services is, however, crucially dependent on their ability to finance the costs (Kriz, Paulus and Staehr 2006). Therefore, according to Article 9, no. 1 of the European Charter of Local Self Government, local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, which they may dispense freely within the framework of their powers. The latter issue is important also in absorbing the EU Structural Funds, where the necessary factor is the ability to co-finance the projects from the local level. Therefore, the ability to apply for funds is determined by the size of the local budgets. Although municipalities in Estonia carry a crucial role in regional development, and most of the resources for this should come from the local budgets, actually the financial dependence on the state determines on what scale the development projects can be planned besides necessary operational costs of the municipalities. So far, there has not been much room for these investments among the Estonian sub-national level. The inter-governmental system in Estonia confers substantial *de-jure* autonomy to local governments but the autonomy is *de facto* restricted, partly because of financial and other constraints, and most local governments in Estonia remain heavily dependent on the central government for revenue (Kriz 2008). On the one hand, the central government gives freedom to the municipalities, leaving them more or less alone with no resources; on the other hand, the state is expecting municipalities to be active, independent and efficient (Tõnnisson 2004, 6). Altogether, local governments in Estonia have many responsibilities and most of them entailed by central government but no resources to implement them. This situation has been addressed more seriously in 2010 when the Estonian Supreme Court declared the organisation of local government funding to be in conflict with the Constitution (Estonian Supreme Court). Currently laws do not differentiate between the funds prescribed for the performance of the duties of the state and the funds prescribed for the resolution of local issues. Accordingly, rural municipalities, towns and cities are not handed two separate pots of money for two different types of duties, which is their right according to the Constitution.[12]

[12] The Constitution requires laws to describe in detail which of the obligations assigned to rural municipalities, cities and towns are duties of the state and which of them are local duties. The expenses associated with the performance of the duties of the state must be covered from the state budget. As a result of the Supreme Court's ruling, the *Riigikogu* has to pass laws that would allow a differentiation between funds prescribed for the performance of the duties of the state and the funds prescribed for the resolution of local issues. These laws must guarantee that duties of the state are funded from the state budget and that local governments have sufficient funds for local duties.

The latter is only a very recent process and may take effect only in future years. Therefore, in order to find a solution to the financial problems in local authorities by means of Structural Funds, limited revenues and the dependence on the state budget has so far illustrated a strong restriction by making the requirement to match funds from local budget almost impossible to fulfil for many local authorities. Accordingly, the most important reason why local governments in Estonia have not been able to take advantage of the EU Structural Funds has been the absence of necessary co-financing of the projects (28% of the respondents, see figure 1). This was also elaborated in the meetings with the representatives of the local authorities. Moreover, the second most evident restriction has been the too expensive preparation process of the projects (21% of the respondents). This reflects the low financial ability of the Estonian local authorities even more.

In light of the co-financing problems from local budgets, some other possibilities for matching funds may become eligible. One of these possibilities is to take a bank loan for co-financing. An interesting fact appeared from the survey that while until 2005, most of the local governments had still ensured the necessary co-financing from the local budget (52%), in the coming years, already 64% of them planned to use loans. Only 20% were confident that they would be able to use local budget in order to cover the co-financing of the projects (Innopolis 2005, 29-31). This fact is actually quite worrying. Local governments can take loans strictly on the condition that the total amount of loans and other factors with loan associated costs (interest etc.) do not exceed 60% of the current budget's revenue, excluding loans and block grants from the state budget, and if the sums for paying back loans and loan interest in all financial years do not exceed 20 per cent of the revenue of the last accepted budget, loans excluded (Parliament of Estonia 1993a, art. 8, section 1). Therefore, there is a limit to taking loans. It is evident that the lack of necessary financial resources is one of the strongest problems in absorbing the EU Structural Funds facilities and will remain so in the future. Most of the local governments already face limits when taking loans imposed by the law. Moreover, the overall economic recession that for the sub-national level in Estonia culminated in 2009 has dramatically reduced the income tax revenues of local governments.[13] This intensifies the vicious circle as municipalities try to compensate the deficit by loans which, in turn, are unreachable due to the imposed legal limits.

6.5 The "eligibility" problem and the lack of appropriate Structural Funds measures

When evaluating the absorption capacity of EU Structural Funds among local governments, it is important to look at the eligibility of actions taken under EU structural funding. De Rooij (2002) related this to the overall absorption of Structural Funds. This was also investigated in the survey, mainly by asking if there are proper measures co-financed by the Structural Funds and which kind of measures are most needed at the local level. Nineteen per cent of the respondents (see figure 1) indicated that there are no appropriate measures for their development activities,

[13] According to the Estonian Tax and Customs Board, the decrease has been 10-20% on average.

meaning that very often, their needs do not meet the eligibility criteria of Structural Funds. This reason was in third position in the explanations of why the funds are not properly absorbed at all.

The lack of appropriate funding schemes was mainly related to infrastructure projects as in 44% of the responses, infrastructure investment support[14] was most needed from the Structural Funds. According to the Local Government Organisation Act (Parliament of Estonia 1993b, art. 6), tasks of local governments are to ensure immediate physical and social living environments for people and technical infrastructures required for supporting such environments. The financing of municipal infrastructure investments and the attendant problems are thus indeed crucial for understanding and carrying out effective regional development policies. Moreover, it is essential to recognise that the efficiency and effectiveness of the funding policies in turn depends to a great extent on the efficiency of the local government system (Kálmán 2002, 42). The availability of capital investment grants from the central budget and from the EU funds are dependent upon local governments providing their share of co-financing, which they are often not able to do, as evident from the discussion above. Therefore, considering the situation of local budgets (and the contributions necessary for obtaining state support), the capacity for making investments into basic infrastructures as well as investments related to local development (e.g. setting up the necessary environments for tourism and businesses) are very limited. Thirty-five per cent of the survey respondents claimed that the importance and needs of infrastructure investments is three times greater than has been the support from the EU pre-accession assistance and other state funds in 2000-2004 (Innopolis 2005, 45).

Besides the lack of appropriate infrastructure-development measures, another huge problem is the cost of preparation of these projects (detail planning, preparing construction projects, conducting tender procedures). The survey shows that more than 20% of all the financial needs from Structural Funds under "soft projects" would be directed to different infrastructure investment preparation works (after the development of human resources and economic development activities) (Innopolis 2005, 26). Such works were not eligible for funds in 2004-2006, which helps to understand the results. Moreover, 35% of the municipalities can undertake development projects only with the help of the Structural Funds (Innopolis 2005, 40). That is why the risk of undertaking these preparations is very high when municipality has to find own sources for financing them.

6.6 Factors influencing Estonian local governments' absorption capacity

European integration has different consequences for municipalities in different Member States. But within Member States, there are also differences between

[14] Under infrastructure investments, the largest financial amounts (48.3% of all the reported financial needs under infrastructure investments) are needed in transport infrastructure (roads and streets in the municipality), environment infrastructure (waste and water systems – 23.9%) and municipality buildings (schools, kindergartens, libraries etc. – 18.1%). For a thorough analysis on categorising infrastructure projects and their importance in local governments in the light of receiving financial support from Structural Funds according to the survey, see Innopolis 2005.

municipalities in the use of opportunities (Bache and Jones 2000, Benz and Eberlein 1999). National constraints can hamper the use of opportunities by one municipality but not by another. The variances in national constraints with which municipalities within one Member State are confronted may be deduced from differences in municipalities' resources. The following will investigate the possible reasons which may induce and cause disparities among Estonian local governments to influence their ability to absorb the funds and use their available resources.

Size of Estonian local governments

De Rooij (2002) found that the size of local authorities strongly influenced the ability to successfully absorb the funds in the Netherlands. Thus, this can be a reason for the relatively weak absorption capacity of Estonian local governments. Usually the population size is taken as the main criterion in analysing issues related to the size of the units (Randma-Liiv 2002, 374). The population size of the local governments in Estonia ultimately influences its financial capacity as most of the revenues of the local governments form part of the personal income tax. The smaller local governments are, the greater are the disparities in per-capita local taxable resources and expenditure needs and so the greater is the need for central government intervention in the form of intergovernmental grants (Bailey 1999, 32). The size of the local governments in Estonia varies widely, from approximately 70 inhabitants in the smallest to approximately 400,000 inhabitants in the largest. The majority of Estonian municipalities is small, with 70% of the municipalities having less than 3,000 inhabitants, and also remains heavily dependent on the central government for revenue (Kriz, Paulus and Staehr 2006).

The main argument behind the assumption that smaller municipalities are worse off when competing with larger ones for the Structural Funds money comes from the claim that the latter have more financial resources and therefore more scope to appoint extra employees, seek for information from the EU, lobby the government and main EU institutions or, most importantly, to match funds. This argument found proof in De Rooij's study on the Netherlands (2002) and also in Zerbinati's study on Italy and England (2004). Despite the fact that the administrative and financial capacity of large municipalities can be undermined by a number of factors as well, it is generally acknowledged that both greater flexibility in using financial resources and advanced possibilities to hire skilled specialists make large administrative units more viable for promoting development and for accessing additional funds from aid schemes such as EU Structural Funds (Ignatov 2004, 9).

Approximately 80% of the local governments included in the survey have less than 5,000 inhabitants, therefore problems and restrictions identified in this study presumably can be related to the small size of the local authorities in Estonia. Further, table 1 presents the results given in figure 1 above according to the answers indicated by the municipalities belonging to different population size group. It appears that the restrictions for applying for Structural Funds were most apparent in municipalities with a population size of 1,000-3,000. This can also be explained by the fact that this group was best represented in the study. Still, the largest municipalities, including Tartu, Narva and Pärnu City with approximately 100,000, 80,000 and 25,000 inhabitants respectively, accordingly did not express the same reasons. Therefore, it can be assumed that the greatest problems with the financial and administrative capacity in Estonia are the problems of smaller municipalities. However, the actual importance of the size variable needs to be further researched, especially in light of the existing research claiming that size alone cannot be the determining factor in the success or failure of the municipal performance (see especially Drechsler 2000, 2007).

Table 1. **Reasons for not applying for Structural Funds among different size groups of the municipalities**

Responding municipalities by population size **Reasons for not applying for Structural Funds (% of all responses in the category)**	**less than 1,000**	**1,000-3,000**	**3,000-5,000**	**5,000-10,000**	**more than 10,000**	**unknown**
No need to apply	0%	25%	75%	0%	0%	0%
Not aware of different grant schemes	0%	0%	50%	50%	0%	0%
Non-existence of appropriate measures	0%	60%	22%	18%	0%	0%
Lack of necessary co-financing	12%	61%	10%	7%	0%	10%
Lack of project preparation and/ or management skills	10%	50%	40%	0%	0%	0%
Project preparation costs are too high	10%	47%	23%	7%	3%	10%
Lack of cooperation partners	0%	67%	33%	0%	0%	0%
Applying for Structural Funds is related to overwhelming red tape	7%	52%	19%	11%	0%	11%
Other	0%	33%	0%	33%	33%	0%

Local government administrative territorial reform

In light of the absorption-capacity problems and empirical results on this matter, not to mention the situation where currently many municipal units are not able to exercise their tasks fully and in an effective way, there has been an ongoing discussion about a further rationalisation and reduction in the number of counties and local governments in Estonia. However, such an administrative unit reform (in the sense of reducing the number of municipalities) should be based on a careful and professional analysis of tasks and the influencing environment. Bigger units probably will not actually solve the municipalities' performance problems as too large units are difficult to manage on the personnel level, to coordinate and to communicate in (Drechsler 2000). They actually cause the need for a greater hierarchical and less horizontal structure and movement towards centralisation, which, in turn, may interfere with the overall idea of democratic local government (ibid.). It can be the case especially for Estonia, where the actual territory and surface area of the municipalities, as well as the relatively low population density, can have dramatic effects in this scenario. Local governments with small populations in Estonia can have territories of 3,000 square kilometres. Seventy per cent of the Estonian municipalities have less than 3,000 inhabitants, and less than 20% of the total population reside in these municipalities, even though they cover approximately 70% of the total surface area of Estonia (Ulst 2000, 10). There is a danger that setting the target size of the population of local governments as the only criteria for consolidation may result in a situation where the area of amalgamated local authority units becomes so large that local inhabitants, especially in peripheral settlements, will not identify with the municipality they live in (Ignatov 2004, 51). Small and compact territory instead favours networking in municipalities (Raagmaa 2002, 73), which is ultimately needed for the total development of the unit, not to mention that a small unit is also more responsive to local needs. For example, this was successfully illustrated even in Germany by the Supreme Court of the Land of Mecklenburg-Vorpommern, which struck down the county reform for 2009 proposed by the state government with the reasoning that creating so called mega-counties violates the right to municipal/county autonomy and responsiveness to citizens' needs, which ultimately outweighs the assumed efficiency gains from larger units (Drechsler 2007). Therefore, even though the results of the current study seem to favour the claim that smaller municipalities in Estonia are worse off when applying for the EU Structural Funds, it may well be that other problems are more important in determining the absorption capacity of Structural Funds as well as municipalities' overall performance, which cannot be overcome simply by reducing the number of units and thus creating bigger local governments. Sharp core-periphery differences in Estonia and the lack of cooperative culture between municipalities as well as with the central government are in this sense the most important factors that should be addressed with effective regional-policy development.

Core-periphery problem and the lack of cooperation

The overall regional policy in Estonia is built around the core-periphery problem. Great regional disparities in such a small area are remarkable in the EU context. One municipality, the city of Tallinn, contains about one-third of the Estonian population, and the capital region in northern Estonia has a per-capita GDP which is more than twice the level of any other region (Kriz 2008). The result is an intensification of unequal spatial allocation of capital and investment. Such regional problems can be solved only if local administration everywhere in the country, including the countryside, is working well (Wrobel 2003, 280).

One important survey similar to the current empirical study was conducted by Oppi and Moora (2004). They investigated the Estonian local government's ability to apply for finances mainly from EU pre-accession instruments. Their analysis shows that the socio-economic status of a local government can be considered to be one of the central factors in its participation in the regional aid programmes. This, in turn, is related to the central core-periphery problem calling for strong regional policy. Although the logic of regional policy would suggest allocating funds to regions or local governments that lag behind, the experience of the selected cases in their study showed the opposite. Oppi and Moora (2004) therefore claim that European funds, to this day, have been distributed mainly to those local governments that have higher socio-economic potential and which belong to the more developed parts of Estonia.

Those with the greatest social problems are often unable to participate in these programmes due to the administrative and financial capacity problems discussed thoroughly above. The current research also indicates absorption capacity problems by local governments in Estonia as emphasised mainly by peripheral and smaller municipalities according to the respondent profile analysis. Even though the study is yet insufficient to explore the overall effectiveness of the EU Structural Funds in fostering regional development, in light of these findings, it can be assumed that actually Structural Funds may have been a source of even greater disparities in Estonia.

While not having sufficient administrative and financial capacity, a solution for local governments should be cooperation in the provision of important public services. However, local governments in Estonia are not used to cooperating and often have conflicting views. As a heritage from the past, this kind of non-cooperative culture has resulted in many ineffective investments or in no necessary investments at all in many important service-provision areas. Also in applying for funds, municipalities are mostly competitors to each other rather than cooperation partners. For example, this survey showed that only five per cent of the respondents indicated that they have used partners' co-financing in the projects in case of a lack of own resources, and only seven per cent were planning to use this possibility in the future (Innopolis 2005, 29-31). Some of the respondents of the study and participants in additional meetings in the municipalities indicated that common provision of services is difficult to realise while every municipality wants to own these investments. Moreover, special laws regulating possible ways to cooperate are still missing in Estonia.[15] A more precise legal framework can be of benefit to enable local governments to choose between more or less organised or independent institutions for cooperation (including the private sector). Additionally, it is important to encourage the municipalities to use these possibilities either by empowering the role of regional and national associations of local governments or by specific institution-building actions fostered by the central government as the ability to achieve coordination on their own is rather complicated when experiences in this field are limited. Therefore, a strong and participative regional policy, as also encouraged by the EU, is needed, together with more intense attention to local government institution-building from the central state level, in which also the role of local government associations as analyst of the local situation, planner of regional development, mobiliser of the resources, advisor, activator, informant and leader should be formally increased and enhanced. To search for solutions merely from administrative units, structural reform may bring along new problems and should therefore be regarded with caution.

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[15] Local Government Organisation Act (1993) § 35 (1) only states that a rural municipality or city may found agencies for the provision of important services, may be a partner or shareholder in a company of significant importance in the development of the municipality, may found foundations and be a member of a non-profit association. The Local Government Associations Act sets the conditions for voluntary cooperation in regional local-government associations, which do not form the second tier of local government but only illustrate the voluntary cooperation between the municipalities and common-interest representation. Currently there are 15 regional associations (one in every county) and two national associations of local governments in Estonia.

7. Conclusion

Since the Treaty of Maastricht, economic and social cohesion of regions in Europe has been one of the justifications of the EU. The accession of ten new Member States in 2004 considerably enlarged the disparities between the EU regions. Being one of the new Member States, Estonia is acquainted with severe regional development problems. There are considerable income disparities within the country, the differences are growing over time, and the capital region in Northern Estonia has a GDP per capita which is more than twice the level of any other region in the country. In overcoming these problems, the Structural Funds as main instruments of EU regional policy play a central role. Therefore, the purpose of the article was to assess the Estonian local governments' absorption capacity of EU Structural Funds and the factors influencing it.

The analysis shows that absorption capacity from the demand side may be an important factor in the overall absorption of Structural Funds in the country. Absorption problems can arise due to macroeconomic, administrative and budgetary problems. The absorption capacity of Structural Funds of most of the responding local governments can be evaluated as being quite low. Most of the problems seem to concern the lack of competent staff and skills for preparing projects. Therefore, the organisational adaptation identified by some other researchers in the EU Member States, due to the new possibilities that have come to municipalities with EU funding, has not been very evident among Estonian local governments. In many cases, mostly in more peripheral local authorities, the officials in place are unaware of most of the rigid EU requirements and unable to use these new funding possibilities. Moreover, Estonian local governments face huge financial absorption-capacity problems, which is the most important reason why funds cannot be used effectively. In the condition of functional and financial dependence on the state being as strong as it is in Estonia, one should not expect local governments to be capable of being ahead of the development process. In addition, the decision-making power of the Estonian local authorities is weak, and little evidence of the existence of regional identities or strong elite support for meso-government can be seen. Therefore, the other aspect related to administrative capacity – proactive attempts – also seems to be weak, even though it is recognised that municipalities that lobby are also more successful in receiving funds.

All these problems with weak administrative and financial capacity may be related partly to the small size of the local governments in Estonia. The solutions may not be easy to find. The administrative unit reform may not be the best solution, as indicating only the size of the population may ultimately disturb the democratic values and the initial idea of local government due to the low density of population and the relatively large surface area of local governments in Estonia. Instead, most of the problems lie in the core-periphery dichotomy and the lack of cooperative culture, and this is the place where regional policy plays a crucial role. Besides mere regional aid programmes, more emphasis should be placed on the institutional capacity-building of local governments, especially in more peripheral regions. In addition, the local government fiscal system needs proper reconsideration, and with the Estonian Supreme Court resolution from 16 March 2010, an important step in this direction has already been taken.

Structural Funds can be regarded as the backbone of the EU regional policy in the Member States and definitely in Estonia. Thirty-five per cent of the respondents (among the relatively badly off municipalities of Estonia) claim that they certainly will not be able to implement the needed development activities in the local government without the help of the Structural Funds. The biggest problem in absorbing the funds has been the lack of necessary co-financing, which should be serious food for thought for the regional policy implementers in Estonia. Estonian municipalities are highly dependent on EU funds, and even with the availability of these funds, problems are difficult to overcome due to weak fiscal decentralisation. Measures to support poorer municipalities in light of the huge absorption-capacity problems of the EU Structural Funds should be carefully analysed in order to mitigate problems in preparing successful bids and, what is more important, in order to create measures that are suitable and actually needed at local levels. Further, more objective quantitative research would be beneficial in order to indicate disparities in the absorption of Structural Funds caused by regional location, the size of the units, the size of the budgets of local governments and other possible indicators where the sampling should cover approximately all municipalities in Estonia. This research would be a great addition to the current study, helping to find causes and solutions to problems that have been indicated here as well as in other EU member countries already in previous years.

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Meetings and Interviews

Lääne-Viru County, meetings with the representatives of local governments (represented were all local authorities from the Lääne-Viru County), 13 December 2005.

Pärnu County, meetings with the representatives of the Audru, Sauga, Tahkuranna and Häädemeeste municipalities and Pärnu City, 08 February 2006.

Jõgeva County, meetings with the representatives of the Põltsamaa, Mustvee, Saare municipalities and Põltsamaa and Jõgeva City, 22 February 2006.

Tartu City, meeting with Vice-Mayoress Karin Jaanson, 1 March 2006.

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