

Financial assistance of EU in Albania

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Abstract

In this paper is discussed the financial assistance of the EU to Albania due to the lukewarm treatment of this theme by local literature. EU provides funding to support countries which aspire to be a part of it, in order to help them meet the standards they need. This study consists of two main parts. It will initially present a theoretical view to make readers familiar with the topic. Then, it will continue to the practical level; through an econometric model we will try to measure the financial impact of IPA funds in one of the most important macroeconomic variables, the GDP growth. This paper intends to implement findings about the positive effects of these funds and come to recommendations to adjust problems and increase the level of absorption of IPA funds in Albania.

KEYWORDS: IPA funds, Albania, GDP growth, absorption.

INTRODUCTION

The European Union (EU) is the biggest economic, political and cultural alliance in the world. The growing role of EU will be a significant challenge in the years to come. The nowadays changes in the modern society increase the role of united Europe, that must be capable of protecting its own interests by continuously promoting principles of democracy all over the world. All these, cannot be reached without internal cohesion and economical power inside the EU itself. Because of that, the EU develops mechanisms with the aim to strengthen economically, prospective members that aspire to be EU members. EU funds intend to develop democratic values in these countries, to build and improve institutions that will implement processes of financial assistance, and thus provide easier use of structural and cohesion funds after entering the EU. These future funds will enable use of bigger financial resources and will create positive impact on economic development, but with a more complex system of functioning. That means that it is of great importance for candidate countries and potential candidates to build an entire system for improving the use of pre-accession funds. But this is not easy because these systems are totally new for Balkan countries. Albania, has actually been profiting from the first two components of these funding programs that are known as IPA funds.

So, the **Instrument for Pre-Accession Assistance**, or simply **IPA**, is a unified funding mechanism of the EU. As of 2007, it replaced previous programs such as the PHARE, ISPA, SAPARD and CARDS. Unlike the previous assistance programs, IPA

offers funds to both EU candidate countries (Albania, Macedonia, Montenegro, Serbia, Turkey) and potential candidates (Bosnia and Kosovo)¹.

Financing under this single umbrella is provided through five "components"²:

1. Transition Assistance and Institution Building
2. Cross-Border Co-operation
3. Regional Development (providing support to transport, environment infrastructure and enhancing competitiveness and reducing regional disparities)
4. Human Resources Development (strengthening human capital and combating exclusion)
5. Rural Development

IPA components III-V are designed to mirror closely structural, cohesion and rural development funds, in preparation for the management of such funds upon accession. It allows beneficiary countries to prepare themselves for successful participation in EU cohesion policy after accession. This should help them to absorb EU cohesion funding more effectively once it becomes available. Under IPA 2007-2013, Components I and II are open to all beneficiary countries whereas Components III, IV and V are open to the Candidate Countries only (current Candidate Countries are: Turkey and Macedonia). However, Albania and Serbia have remained outside the scope of intervention of IPA Component III and IV, because they obtained candidate status too late in the 2007-2013 period. IPA funding is managed under centralized and decentralized management according to strict rules to ensure there is tight control over how funds are used and that the money is spent in a transparent, accountable manner, directed by European Commission.

REVIEW OF LITERATURE

When it comes to EU funding the literature offers a great number of studies that present different aspects of the topic. IPA funds and structural funds make up the bulk of EU financial portfolio. The level of absorption of these funds, their impact on the economy and not only, the difficulties encountered, ways to remedy them, etc., is some of the main issues outlined by many scholars of different countries (mainly countries of Central and Eastern Europe). In one group of IPA projects (component 2), partners from the EU or non-EU countries are necessary³. The idea is that countries, both EU candidates and potential EU candidates, should use simple and unified financial rules to be able of a stronger cohesion and faster integration⁴. We must specify that specific studies about IPA funds are lower than those about structural funds although there may be approximations and analogies due to their similar financial nature and objectives.

¹ https://en.wikipedia.org/wiki/Instrument_for_Pre-Accession_Assistance

² http://ec.europa.eu/regional_policy/en/funding/ipa/

³ Cross-border Cooperation, 2006

⁴ How IPA works, 2009

There are studies focusing on the effectiveness of the Cohesion Policy and the impact of EU funds on the economic growth in the Member States in terms of increasing the GDPs. Also, as Kitov et al. states, economic growth is the most important macroeconomic variable for practical purposes and theoretical considerations that determine speed of the economic development.⁵ The studies about the relation between economic growth and external aid date back to old times. In his study, the panel data analysis is used by Papanek⁶ to test the effectiveness of the external aid in terms of its impact on the economical improvement in the selected countries (for the research, he chose relatively underdeveloped 85 countries from the world). Papanek treated the foreign investment, foreign aid and domestic savings as separate variables and in conclusion, the savings and the foreign aid. In their research, Durbarry et al.⁷ used data of the 68 developing countries from 1970 to 1993 to assess the impact of the external aids on creating economic growth. They used the panel data analysis and used Fischer-Easterly model for the test and as a result, they found strong evidences that the external aid has some positive impact on the economic growth explained more than one third of the growth that was experienced in the selected countries.

Beuran⁸ analyzed twenty five Central and Eastern European Countries from 1990 to 2000. She tested the role of the foreign aid in terms of creating economic growth. She used panel data analysis and she found out that foreign aids actually create growth. Ederveen et al.⁹ used thirteen Member States to explore the effectiveness of the Structural Funds with a data set from 1960 to 1995. They applied the panel data analysis and in conclusion, they stated that the Structural Funds were ineffective. But, on the other hand, in the Member States who has the "right" institutional structure, they came to the conclusion that the Structural Funds are effective. As for another research, Mallik¹⁰ used six poorest African countries to analyze the external aids' role in creating economic development in the selected countries. He used co-integration method and could not find a long term relationship between the external aids and economic development.

We already noticed that quantitative studies about IPA Funds are in a low number compared to Structural Funds. In fact, this was one of the main reasons that affected us in realizing this article. Mirjana Kranjac, Rado Maksimovic and Uros Sikimic¹¹ present the case of Serbia in their study. The research that was performed involved 108 Serbian organizations. A model of use of IPA funds has been created. There have been defined significant points of the process. They found out that there is a lack of project management knowledge in Serbia. Acquisition of knowledge about projects must start long before announcement of call for project proposals. Improvement is recommended through new idea of setting up "Project centers".

⁵ Kitov et al. (2009), pp. 81-85

⁶ Papanek (1973), pp. 120-130

⁷ Durbarry et al. (1998), pp. 17-19

⁸ Beuran (2005), p. 21

⁹ Ederveen et al. (2006), pp. 17-42

¹⁰ Mallik (2008), pp. 251-260

¹¹ Mirjana Kranjac, Rado Maksimović, Uroš Sikimić (2010) pp 35-46

Simonida Kacarska and Riste Jurukovski¹² give in their paper an initial overview of the information available via the IPA database and a preliminary analysis of the use of IPA funds in Macedonia. The first section analyzed the use of the IPA assistance as well as the available, contracted and used funds. The second section studied the influence and links of IPA funds to the basic macroeconomic indicators. The third section presented the relationship between EU funds and the reform accession process. Other articles about IPA funding in Western Balkans, especially in our country, mainly focus on finding difficulties and problems in gaining EU financial aid and giving recommendations for each case. Our study intends to measure the relation between IPA funds and GDP growth in Albania and the region as well, in order to explain through numbers the expected positive impact of these funds.

DATA ANALYSIS

1. Methodology

The econometric models are built in accordance with the purpose and objectives of this topic. Theoretically we expect that IPA funds provide positive impact on the economy. The growth of annual GDP is used as the dependent variable and as the independent variable, the absorption of EU funds (percentage of contracted funds). We have selected the contracted funds because we are interested in the economical maturity of these funds. Both variables are expressed in percentage. The data used in the model resulted from secondary navigation as the main source of getting data, referring to the summary reports drawn up by the European Commission for IPA funds and the website of World Bank. The figures were reviewed during 2007-2013, as it was the period when the countries have benefited from the program IPA I. IPA funds are also allocated for the period 2008-2020 under the program IPA II, but they are theoretical figures and unrelated to economic growth (currently in implementation the funds of IPA I). The data is reviewed only for the first two components to unify the analysis within the region. We obtained the annual GDP growth since the data for contracted funds were available just in annual terms. The period in total 7 years represents a limitation of the study in this case. Linear regression is used to model the data. The data for the region constitute the panel structure since they have two dimensions, individual features and time. In order to unify the analysis between Albania and the region due to the small number of periods, these data are also modeled using simple linear regression. The hypothesis are evaluated in 10% significance level, interval in which, according to the relevant test these hypotheses are accepted. Statistical values reviewed were: Fischer, Durbin-Watson, the correlation coefficient, R², p and the regression equation parameters. The statistical program used was SPSS 22. Data used in the econometric models are given in the table below.

¹² Simonida Kacarska, Riste Jurukovski (2013) pp 20-22

Table 1 : Annual GDP growth and absorption rate of IPA funds in Western Balkans

	% gdp	% abs												
Country	Albania		Bosnia		Croatia		Kosovo		Montenegro		Serbia		Macedonia	
2007	5.9	96.65	5.7	94.51	5.2	94.29	7.3	99.48	10.7	97.98	5.9	97.87	6.5	86.72
2008	7.5	92.83	5.5	93.6	2.1	89.47	2.6	99.51	6.9	97.2	6.4	96.53	5.5	89.07
2009	3.4	98.07	-2.9	98.33	-7.4	93.04	3.3	99.62	-5.7	96.9	-3.1	99.45	-0.4	89.34
2010	3.7	93.92	0.8	95.86	-1.7	72.92	3.3	98.44	2.5	99.79	0.6	99.43	3.4	16.09
2011	2.6	79.28	0.9	50.23	-0.3	3.17	4.6	71.46	3.2	44.88	1.4	79.44	2.3	5.11
2012	1.4	18.19	-0.9	17.57	-2.2	0	2.8	27.15	-2.7	22.15	-1	23.09	-0.5	0
2013	1.1	0	2.4	7.76	-1.1	0	3.4	15.46	3.5	1.93	2.6	0	2.9	0

Source: www.worldbank.org; European Commission reports, Brussels 2014

2. Econometric Models

Albania

H₁: "The relation between GDP growth and the absorption of IPA funds is statistically significant for Albania."

Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.739 ^a	.547	.456	1.71943	1.640

Coefficients

Model	Un standardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	.802	1.332		.603	.573
Fund's absorption	.042	.017	.739	2.456	.058

Hypothesis 1 is accepted because the value of Fischer statistic is higher than the critical. The model is statistically significant, given that the value of $p = 0.058$ is less than 0.1. It does not suffer from autocorrelation since the Durbin-Watson statistic is within the range allowed. The value of R^2 is 0,547 which mean that the GDP growth is explained by the absorption of IPA funds at a rate of 54.7% when other factors that may affect are ignored. Strength of the relation between two variables is measured by the correlation coefficient which in this case holds the value of 0,739 so the relation between variables is relatively strong.

Evaluated equation: $Y = 0.802 + 0.042 * X$

With a 10% error rate we admit that the increase of 1% of the level of absorption of funds in Albania will increase by 0.042% the annual GDP growth. The country should try to achieve the highest possible rate of absorption of these funds because this directly translates into economic growth.

Western Balkans

H₂: "The relation between GDP growth and the rate of absorption of IPA funds is important for the Western Balkans region."

Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.656	.43	.417	3.44812	1.623

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.819	.904		.906	.370
	Fund's absorption	.023	.012	.264	1.879	.066

Our hypothesis is accepted, given that the estimated value of Fisher statistic is higher than the critical value. The rate of absorption of funds explains 41.7% of the regression. Relation between variables is considered relatively strong, starting from the value of the coefficient of correlation. The model is statistically significant given that the value of the parameter p is less than 10%. It does not suffer from autocorrelation since the Durbin-Watson statistic is within the range allowed.

Evaluated equation: $Y = 0.819 + 0.023X$

So, with a 10% error rate we admit that the increase of 1% of the level of absorption of IPA funds in Western Balkans will increase by 0.023% the annual GDP growth.

CONCLUSIONS

From statistics obtained we conclude that the relationship between variables in Albania appears somewhat stronger. Econometric models empirically prove our expectations in both cases. The value of R² is again higher in the case of our country. The impact of IPA funds' absorption on GDP growth in Albania is about twice higher when compared to the region. This may be due to specific factors that affect each country but even more by the fact that EU aid is seen only for the first two components of IPA while other countries have benefited from the other components. Albania gives a good contribution to the

economic growth of the region through the absorption of IPA funds from the first two components. However, there is still much work to be done in this direction in order to maximize its potentials. Here are some recommendations that arise in this case:

- Increase the level of knowledge about IPA funds by informing target groups about possibilities and ways to receive these financial resources.
- Strengthening administrative capacity and preparing national and local structures and authorities to plan and implement such programs.
- The government should predict in their budgets expenses for taxes and co-financing and also gain this financial assistance according to the country's strategic priorities or needs.
- The staff should be qualified and trained in a proper way. They should continuously attend seminars or workshops organized by European Commission.

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