EU funds: What can the Western Balkans learn from the New Member States (NMS)?

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Outline:

- An overview of available funds
  - Comparing IPA and pre-accession in the NMS
  - Prospects for after-accession
- Lessons from the NMS
  - Institutional and legal frameworks
  - Challenges in economic policy
- Conclusions

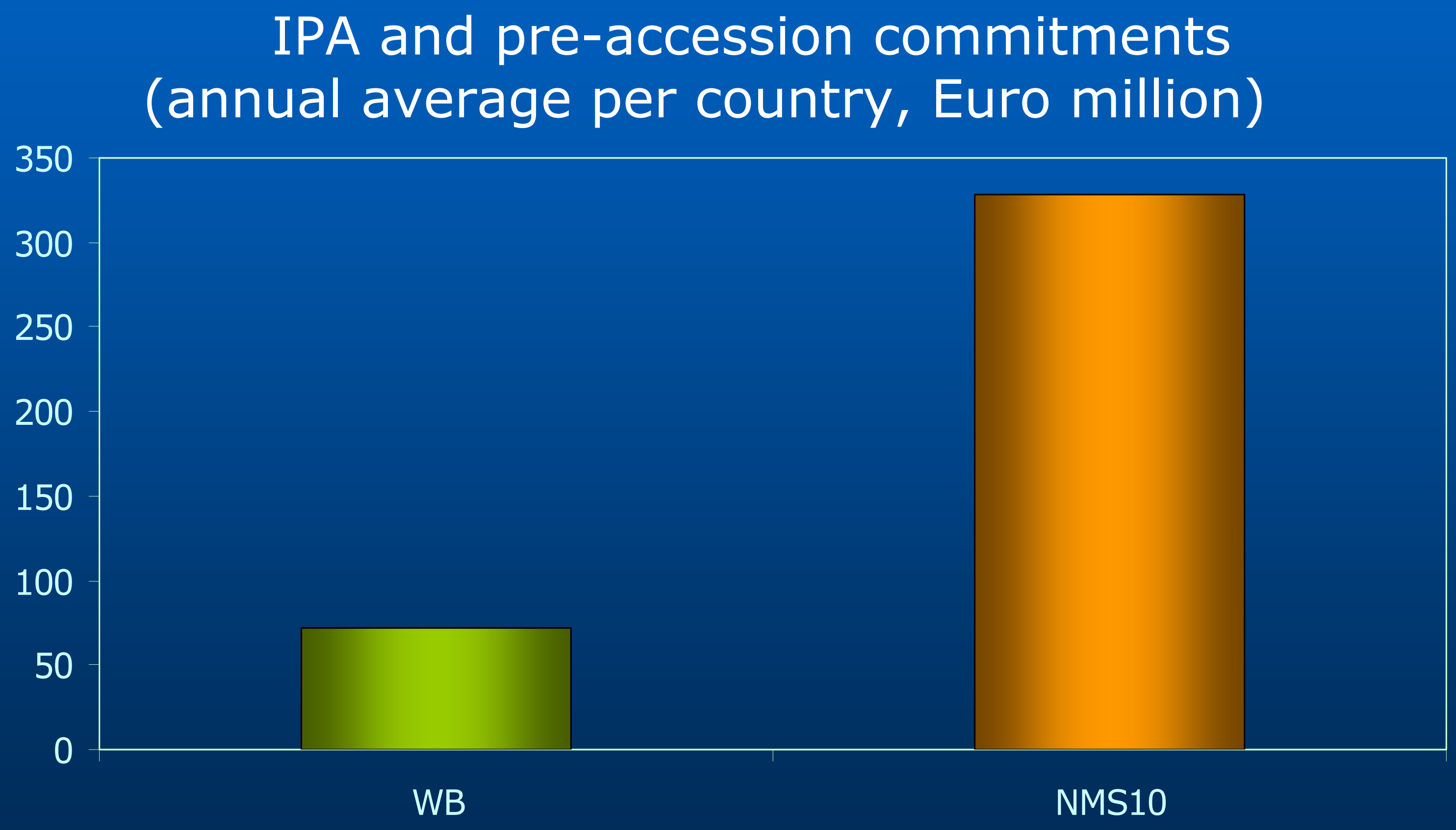
IPA commitments for Western Balkans

Instrument for pre-accession assistance (IPA)
(EU commitments, millions of Euro)

	2007	2008	2009	2007-2009
Croatia	138.5	146	151.2	436
Macedonia, FYR	59	70	82	211
Albania	61	71	81	213
Bosnia & Herzegovina	62	75	89	226
Montenegro	31	33	33	97
Serbia	187	191	195	572
Kosovo	63	65	66	194
Total	**463**	**504**	**546**	**1513**

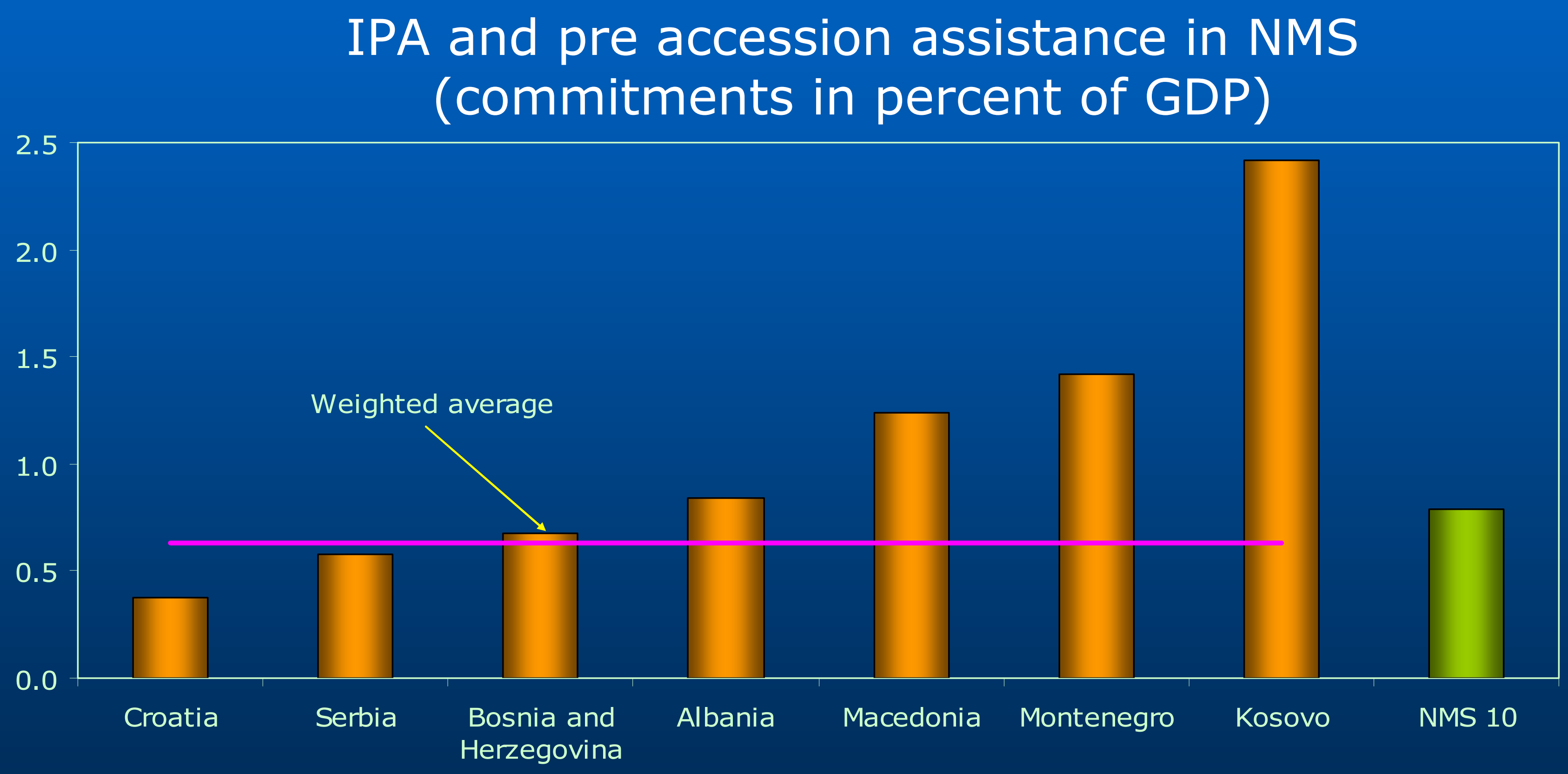
Source: European Commission (EC).

While IPA is lower than pre-accession in the NMS…



Source: EC, staff estimates

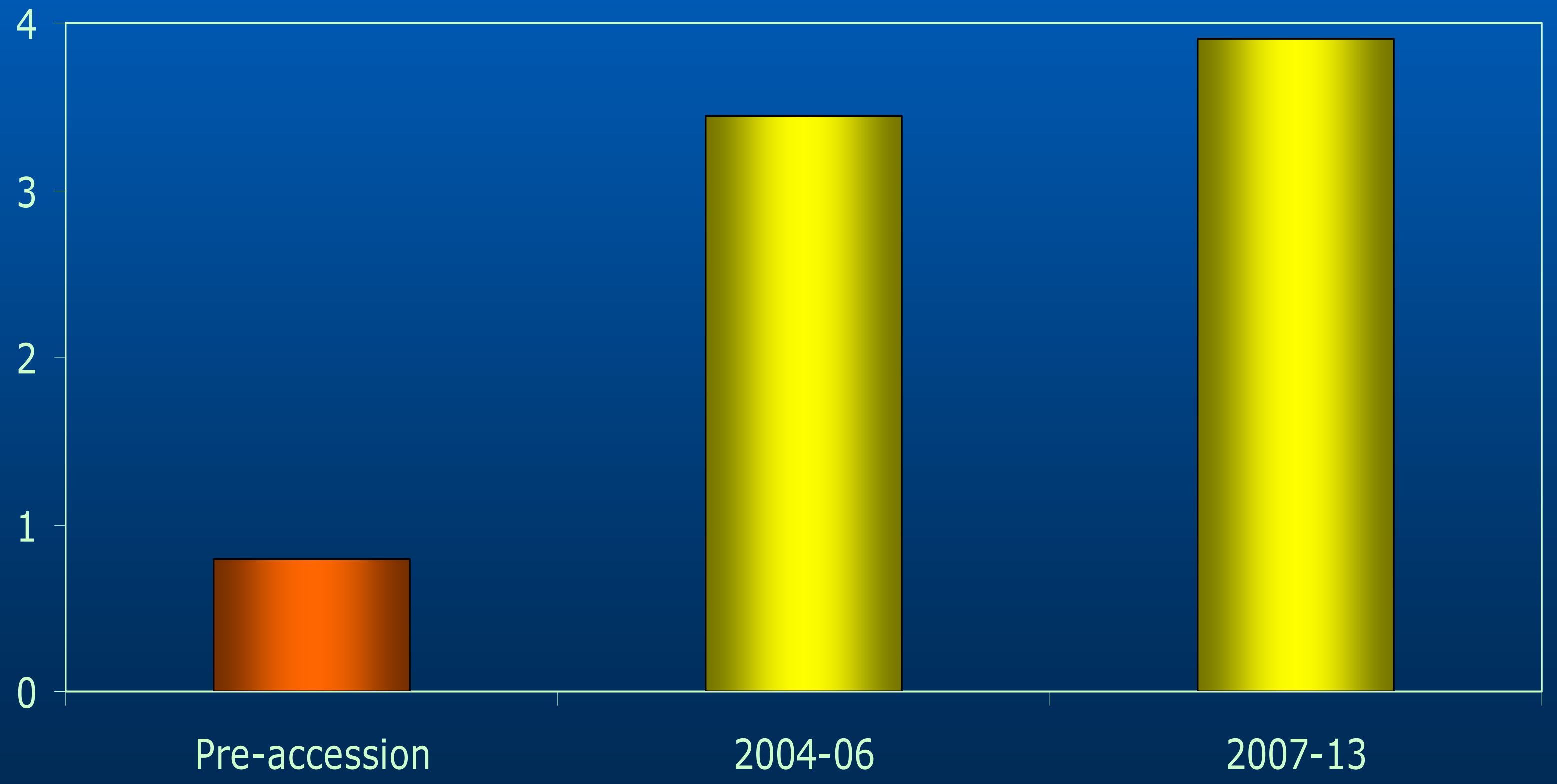
…its economic significance is broadly comparable



Source: EC, IMF, staff estimates

And this may be just the beginning

Comparison of pre-accession and post-accession funds in NMS
(in percent of GDP)



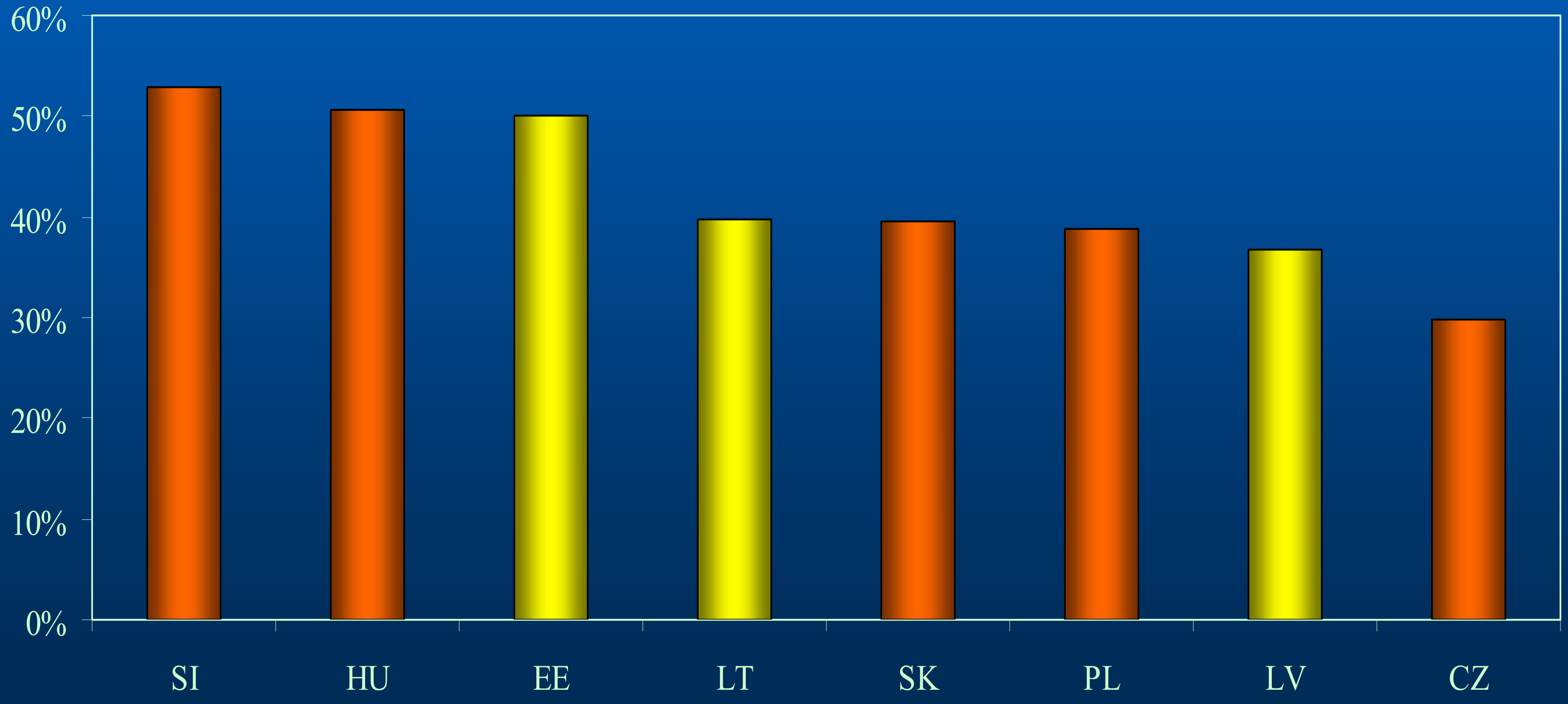
Source: EC, Eurostat, staff estimates

How to manage the increasing EU funds?

- NMS developed two models:
  - "Baltic model": single institution (MoF) acting as both managing and paying authority
  - "CE5 model": different managing and payment authorities—MoF detached from managing role
  - *Different role of regional authorities: the strongest in Poland, the largest country among NMS*

It is hard to judge which model works better

NMS: Absorption of EU structural funds
(claims for interim EU refunds as of June 2007,
in percent of 2004-06 commitments)



Source: National authorities, EC, staff estimates

Poland's case shows that complex initial setups may evolve…

Poland:
Initial Managing Authorities for EU-financed Operating Programs

1. Ministry of Economy
- Industry
- Human Resource Development
- Cohesion funds (coordinating)

2. Ministry of Agriculture
- Fishery
- Rural Development

3. Ministry of Infrastructure
- Transport
- Cohesion funds (transport)

4. Ministry of Environment
- Cohesion funds (environment)

5. Local governments
- Regional development

…to streamlined versions to ensure more efficient coordination

Poland:
Modified Managing Authorities for EU-financed Programs

- **1. Ministry of Regional Development**
  - Industry
  - Human Resource Development
  - Cohesion funds
  - Transport
- **2. Ministry of Agriculture**
  - Fishery
  - Rural Development
- **3. Local governments**
  - Regional development

Poland: Legal and regulatory changes followed a similar route

Poland: Measures to improve absorption of EU funds:

Payment system	* more frequent and simplified submission of refund claims * accelerated certification of payments * simplified (one-stage) verification of invoices
Legal framework	* simplified public procurement rules * no court appeals on bids below Euro 60,000 * no ministerial regulations required in all program documents
"Political" suasion	* government monthly monitoring of absorption progress against planned targets

EU funds may be a challenge for fiscal policy

A simple framework for assessing the fiscal impact of EU transfers.

(1) EU related receipts

budget compensation

refunds on EU projects

(2) EU related expenditures

contribution to EU

spending on EU projects

national co-financing

Direct fiscal impact=(1)-(2)

(3) Domestic spending substituted by EU transfers

Adjusted fiscal impact (1)-(2)+(3)

Hungary: Fiscal impact of EU transfers (in percent of GDP)

	2004	2005	2006	2007 budget
Transfers from EU	0.8	0.9	1.3	1.9
Expenditure on EU projects	0.4	0.9	1.3	1.8
Co-financing	0.2	0.4	0.7	0.7
Contribution to EU	0.6	0.8	0.8	0.8
Direct fiscal impact	-0.4	-1.3	-1.5	-1.3
Substituted spending 1/	0.2	0.7	1.1	1.5
Adjusted fiscal impact	-0.2	-0.6	-0.4	0.2

1/ Estimate: includes cohesion funds, CAP transfers, and co-financing.

Source:MoF, staff estimates

Demand impact: A very simplified approach

$$D = \alpha \, (T \; + NC) - C - A \; ; \alpha € \{0,1\}$$

D - demand impact

T - transfers received from EU

NC - national co-financing of EU funds

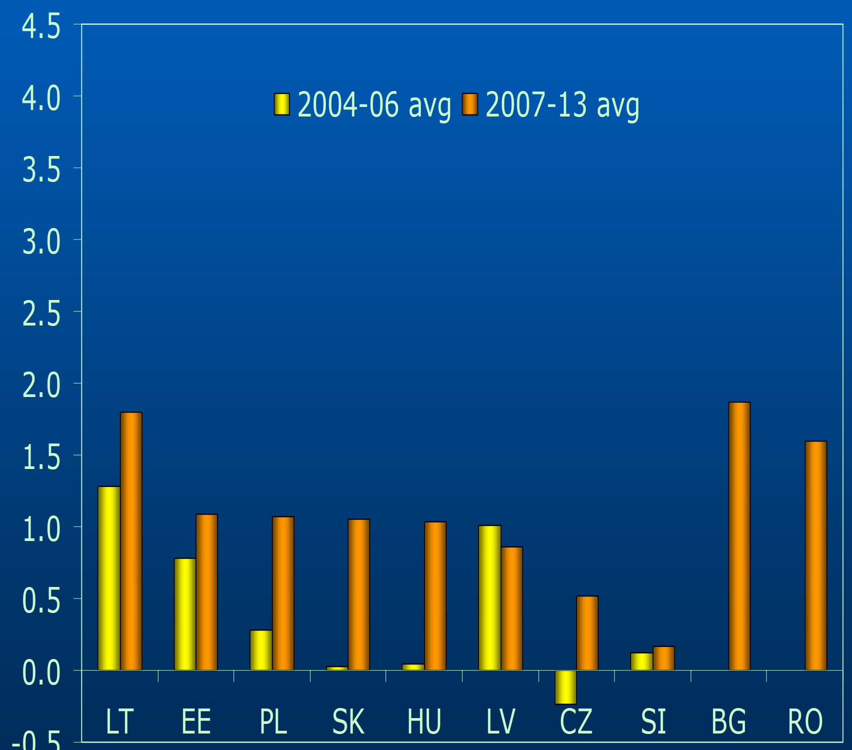
C - contributions paid to EU

A - advances received

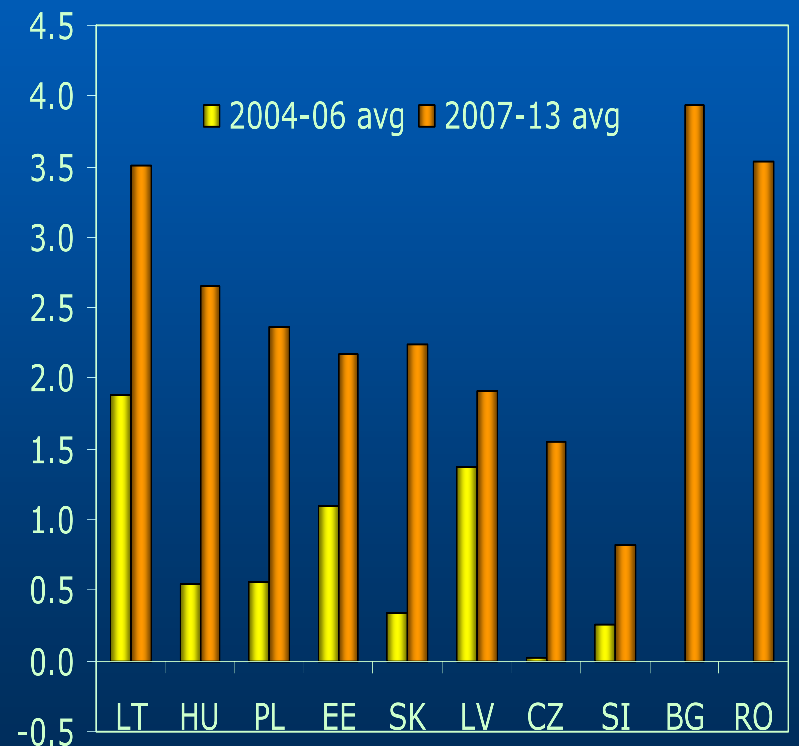
α - degree of substitution between EU- related projects and domestic spending that would have happened anyway (depending on the implementation of additionality guidelines)

First round effect on demand depends on additionality assumptions

Partial additionality
(α= 0.55-0.65)



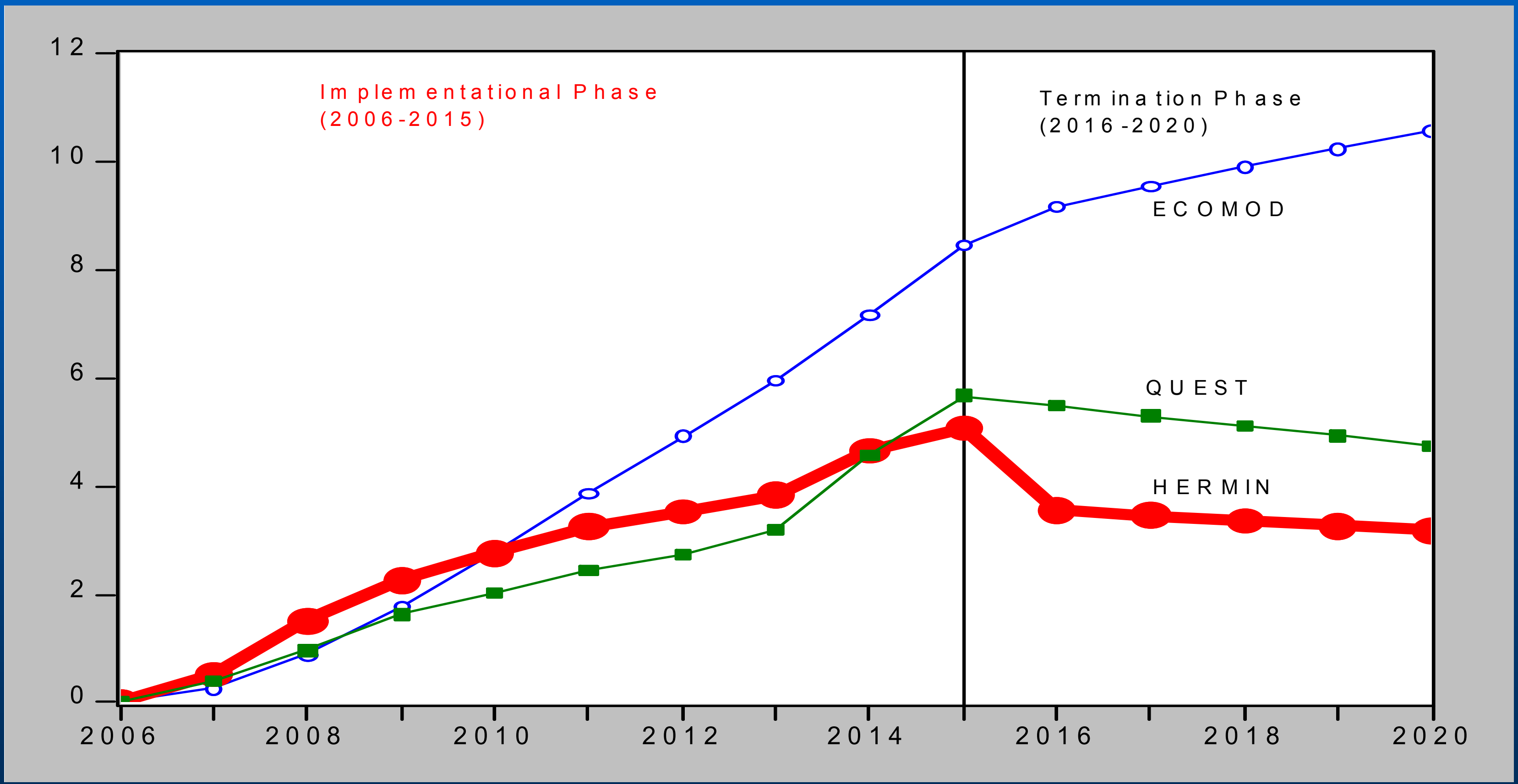
Full additionality
(α=1)



Source: National authorities, staff estimates.

Model-based estimates point at positive, albeit ambiguous, impact on growth

Poland: Impact of cohesion policy on GDP level (deviation from baseline in %)



Source: J. Bradley, G. Untiedt, “Do economic models tell us anything useful about Cohesion Policy impacts?, 2007

EU transfers could also have negative side-effects

- If the recipient economy operates at its potential, the impulse from EU transfers could add to economic imbalances by:

- Creating pressure on wages and prices
- Leading to appreciation of the real effective exchange and undermining external competitiveness

Some conclusions based on the NMS' experience:

- IPA may be just a prelude to much larger funding, it is important to use it well:

- ✓ Institutional and regulatory frameworks should ensure efficient coordination and relatively high degree of flexibility.
- ✓ A possible negative budgetary impact should be considered and, if necessary, prevented by re-prioritizing expenditures.
- ✓ The demand impulse from EU transfers needs to be managed carefully not to add macroeconomic imbalances