

# EU Funds in the New Member States: *Opportunities and Challenges*

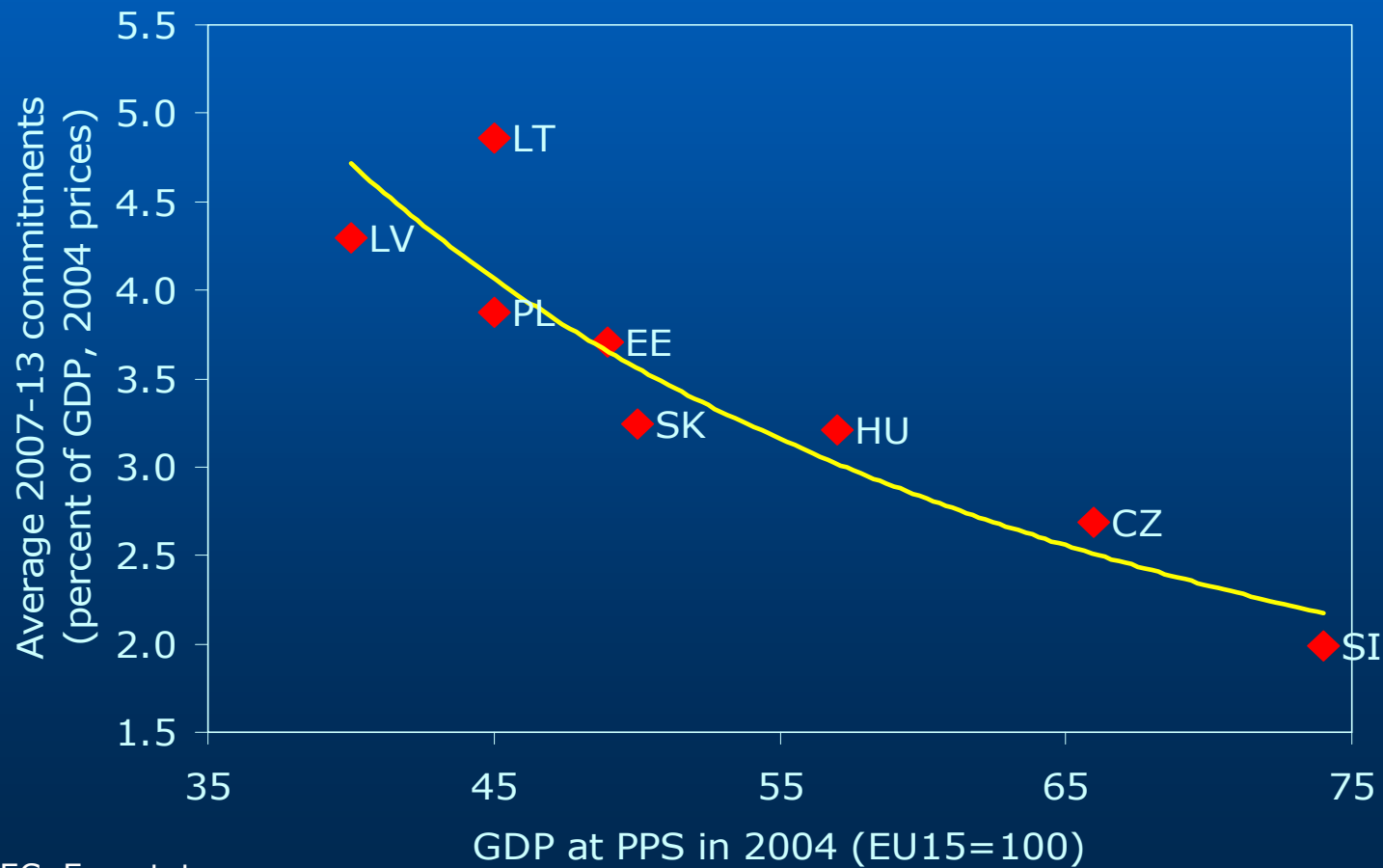
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International Monetary Fund  
February 14, 2007

# Outline

- EU funds available to the new member states
- Budgetary impact of EU funds
- Demand impact of EU funds to date
- Structural funds
- Supply-side effect and broader macro implications: Model based approach

# Commitments largely reflect countries' catch-up needs

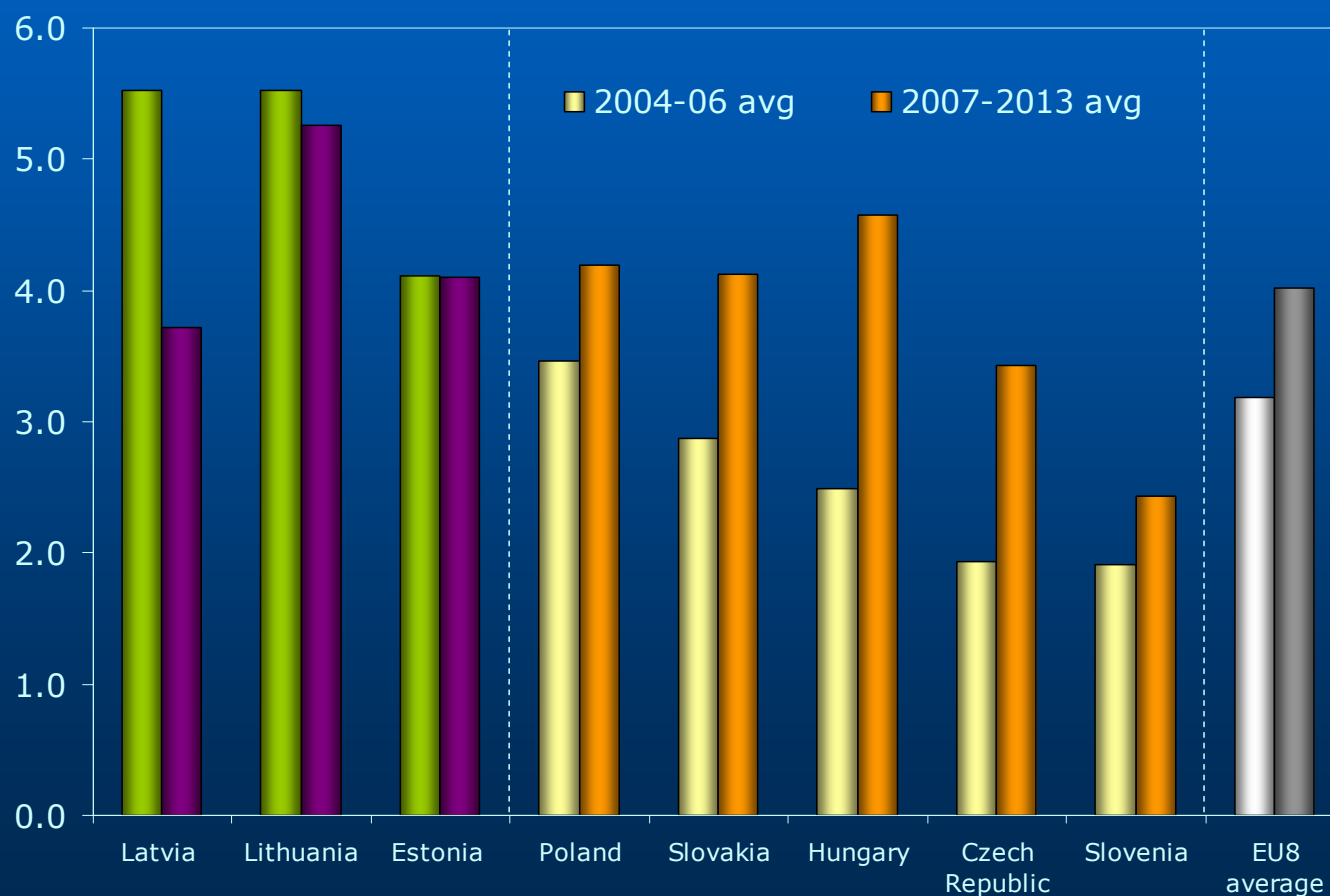
NMS: Average annual EU Commitments and Real Convergence



Source: EC, Eurostat.

# In 2007-13 the relative importance of EU funds will likely increase in Central Europe and decline in the Baltic

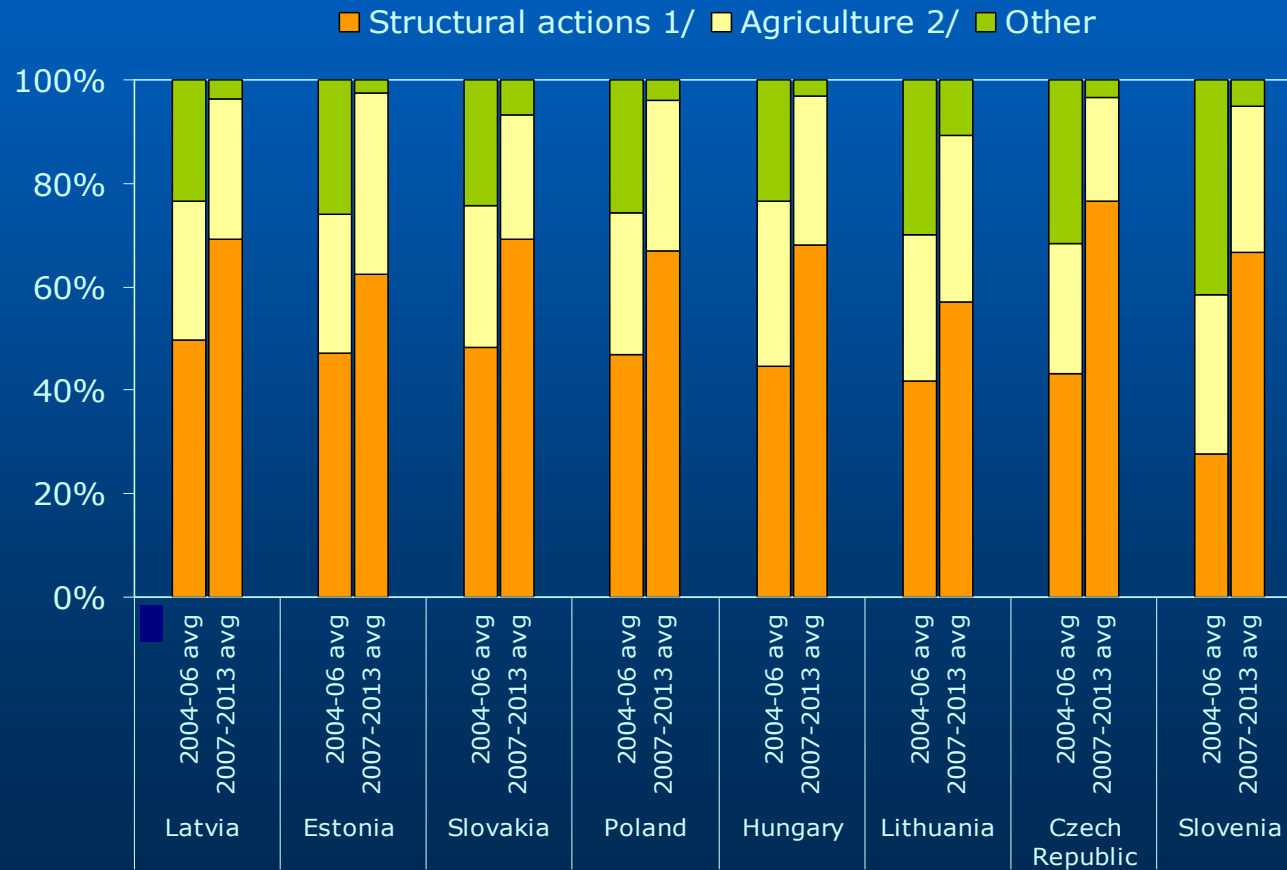
EU8. Average annual commitments as a percent of GDP



Source: European Commission, national authorities, staff estimates.

# Structural Funds are the EU's main instrument to support real convergence

## NMS: Structure of Available EU Funds



1/ Structural actions include structural funds (ERDF, ESF, community initiatives) and cohesion funds

2/ Agriculture includes direct payments, market measures, and rural development (FIFG/EFF and EAGGF (guidance & guarantee)/EAFRD)

Source: European Commission.

# Fiscal impact: Methodological issues

## **ESA95 vs. National cash-based statistics**

- Sectoral coverage (e.g. transfers to farmers)
- Timing of recording
- Treatment of advances

## **Estimation of items often not directly observable in national fiscal accounts**

- National co-financing
- Substituted spending

# Example: Hungary

Estimation of the fiscal impact of EU-related funds, ESA95 methodology, 2004-2006, HUF bn

	<b>2004 Actual</b>	<b>2005 Estimated</b>	<b>2006 Budget</b>
<b>(1) EU related receipts (1)</b>	<b>79</b>	<b>95</b>	<b>173</b>
o/w budget compensation	43	8	8
transfers to government beneficiaries	36	86	165
<b>(2) EU related expenditures</b>	<b>190</b>	<b>361</b>	<b>523</b>
spending on EU projects/policies	36	86	165
contribution to EU	120	186	217
national co-financing	35	89	140
<b>(3) Substituted spending 1/</b>	<b>45</b>	<b>112</b>	<b>191</b>
<b>Net fiscal impact = (1)-(2)+(3)</b>	<b>-66</b>	<b>-154</b>	<b>-158</b>
<b>(in percent of GDP)</b>	<b>-0.3</b>	<b>-0.7</b>	<b>-0.7</b>

Source: National authorities, staff estimates.

1/ Includes all co-financing, agricultural, and cohesion spending

# EU8 countries: Annual fiscal stimulus due to EU-related transfers

	2006			2007			2008												
	2006	2007	2008	2006	2007	2008	2006	2007	2008										
<b>Czech Republic</b>	Headline balance	-4.8	-3.8	-3.3	<b>Estonia</b>	Headline balance	2.7	1.3	1.4										
	Adjusted balance	-4.3	-3.4	-3.4		Adjusted balance	2.1	0.8	0.7										
	Fiscal stimulus:					Fiscal stimulus:													
	<b>headline</b>	1.7	-1	-0.5		<b>headline</b>	-0.4	1.4	-0.1										
	<b>adjusted for EU funds</b>	1.8	-0.9	0.0		<b>adjusted for EU funds</b>	0.3	1.3	0.1										
<b>Lithuania</b>	2006			2007			2008			<b>Poland</b>	2006			2007			2008		
	Headline balance	-1.2	-0.9	-0.5	Headline balance	-1.9	-1.4	-1											
	Adjusted balance	-1.5	-1.8	-2.0	Adjusted balance	-1.6	-1.5	-1.7											
	Fiscal stimulus:				Fiscal stimulus:														
	<b>headline</b>	0.6	-0.3	-0.4	<b>headline</b>	-0.5	-0.5	-0.4											
<b>adjusted for EU funds</b>	0.5	0.3	0.2	<b>adjusted for EU funds</b>	-0.4	-0.1	0.2												
<b>Hungary</b>	2006			2007			2008			<b>Latvia</b>	2006			2007			2008		
	Headline balance	-10.1	-6.8	-4.2	Headline balance	-1.4	-1.4	-1.3											
	Adjusted balance	-9.7	-6.6	-4.6	Adjusted balance	-2.4	-2.2	-2.1											
	Fiscal stimulus:				Fiscal stimulus:														
	<b>headline</b>	2.3	-3.3	-2.6	<b>headline</b>	-0.1	0	-0.1											
<b>adjusted for EU funds</b>	2.3	-3.1	-2.0	<b>adjusted for EU funds</b>	0.4	-0.2	-0.1												
<b>Slovakia</b>	2006			2007			2008			<b>Slovenia</b>	2006			2007			2008		
	Headline balance	-3.7	-2.9	-2.5	Headline balance	-1.5	-1.5	-1.7											
	Adjusted balance	-3.5	-2.9	-3.2	Adjusted balance	-1.3	-1.1	-1.5											
	Fiscal stimulus:				Fiscal stimulus:														
	<b>headline</b>	0.5	-0.8	-0.4	<b>headline</b>	0.1	0	0.2											
<b>adjusted for EU funds</b>	0.7	-0.6	0.3	<b>adjusted for EU funds</b>	0.2	-0.2	0.4												

Source: National authorities, staff estimates.



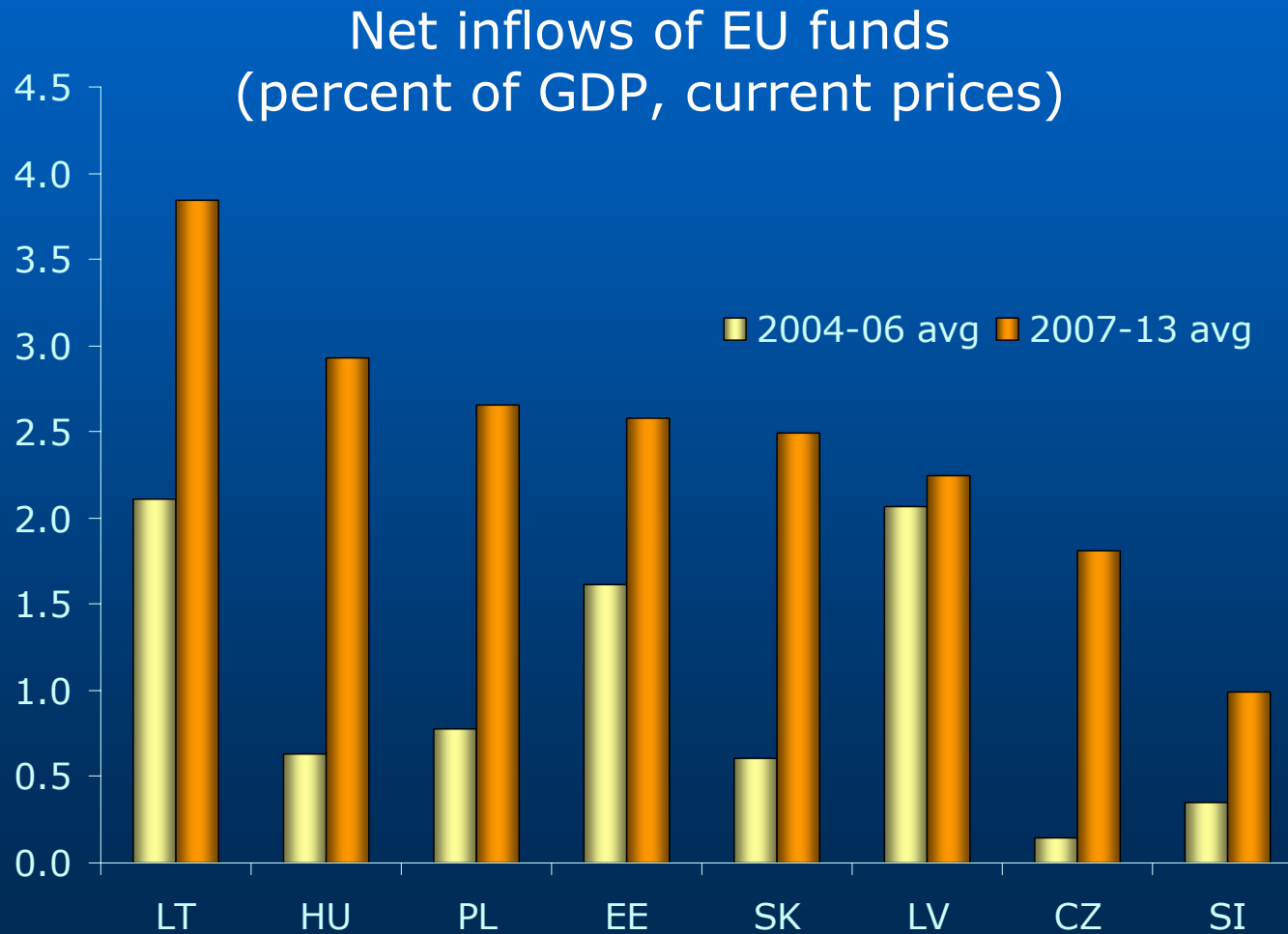
# Fiscal impact: Policy challenges

- Reduce the negative impact on already excessive deficits (Central Europe)
- Reduce hidden fiscal impulse (Baltics)

By:

- Reducing current spending elsewhere in the budget
- Baltic states, with lean governments, may redirect resources from domestically financed inv. spending to co-financing of EU projects to dampen the fiscal impact
- Substituting domestically funded spending to the extent possible
- Ensure transparent recording of all EU related funds in the budget (below and above the line)

# Demand impact: all NMS can expect an increase in net inflows from EU



Source: National authorities, staff estimates.

# Demand impact: Methodological issues

- **Advance payments:** no relation to economic activity
- **Timing:** demand impact does not coincide with the time of reimbursement
- **Additionality:** are EU funds augmenting or crowding out domestic spending
- **Multiplier effects and second round effects:** require a (GE) model.

# Demand effects: a very simplified approach

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

D - demand impact

T - transfers received to EU

NC - national co-financing of EU funds

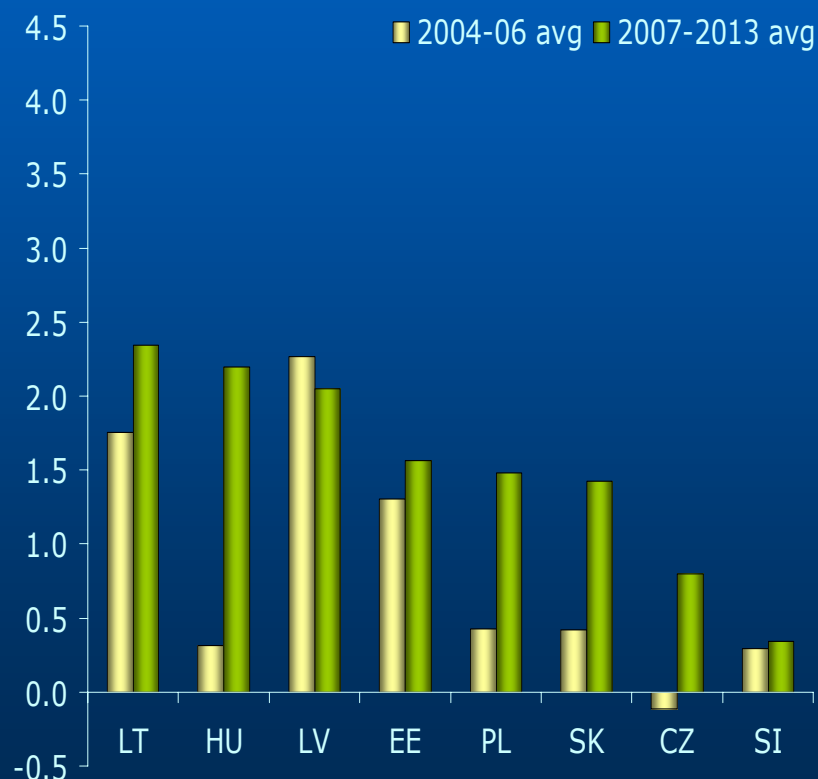
C - contributions paid to EU

A - advances received

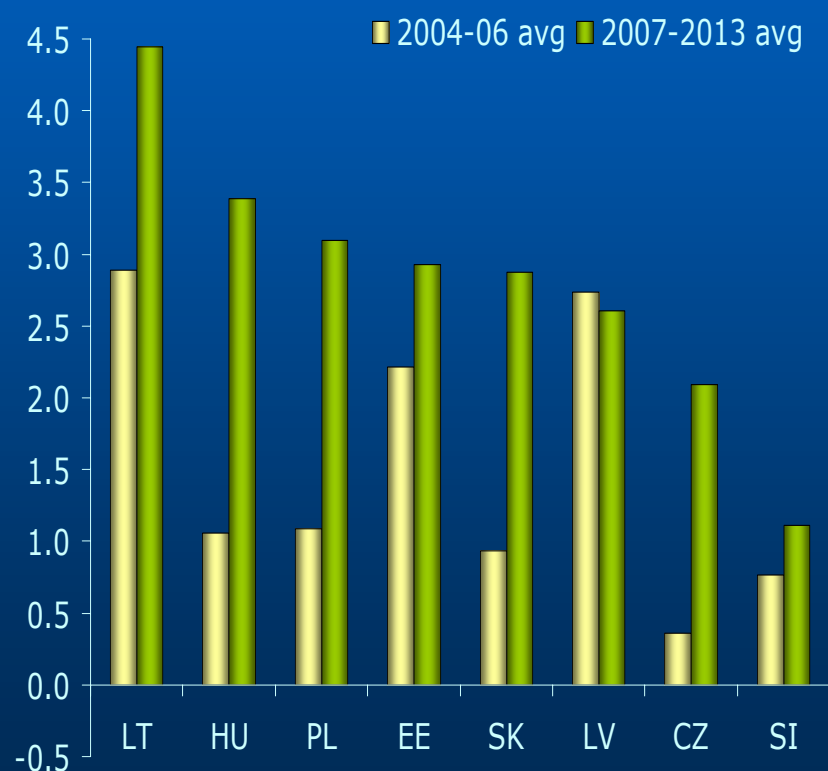
$\alpha$  - degree of substitution between EU- related projects and domestic spending that would have happened anyway (depending on the implementation of additionality guidelines)

# First round effect on demand depends on additionality assumptions

Partial additionality  
( $\alpha = 0.55-0.65$ )



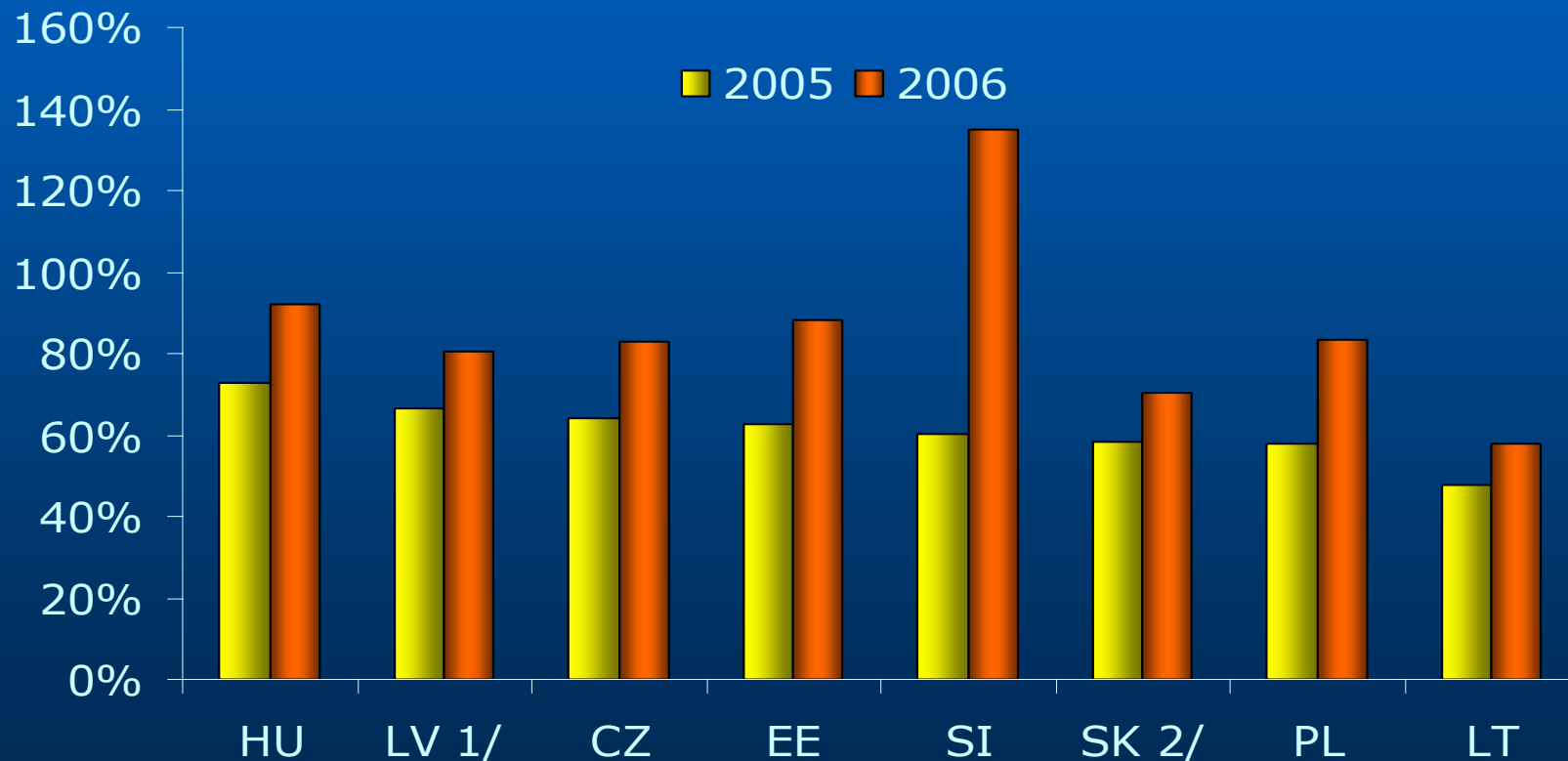
Full additionality  
( $\alpha = 1$ )



# Structural Funds

Demand is high across NMS and most funds are already contracted...

Contracting of structural funds  
(end of October 2006, percent of 2004-06 commitments)



1/ Data for end of September 2006.

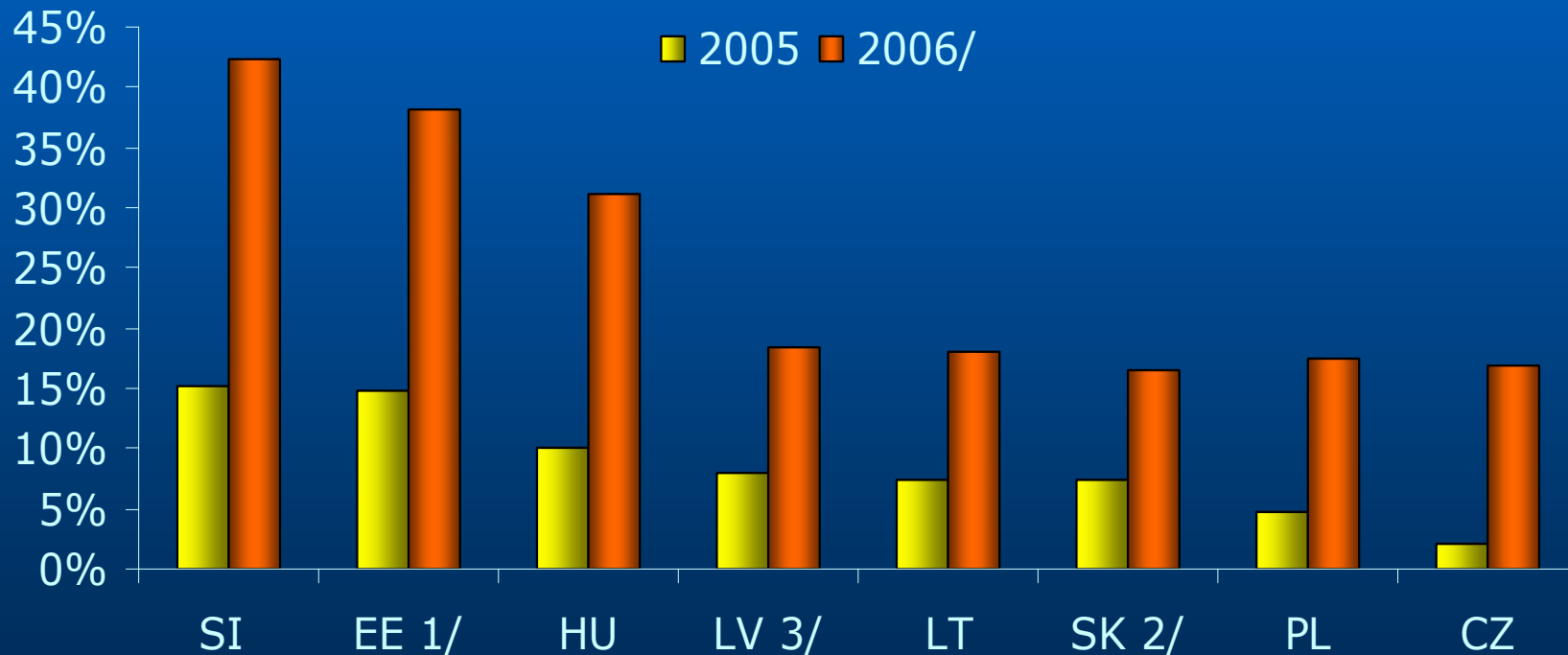
2/ Data for end of June 2006.

Source: Data from national authorities.

# ...but absorption rates differ significantly

Requests for interim payments

(end of October 2006, percent of 2004-06 commitments)



1/ Actual refunds from EU.

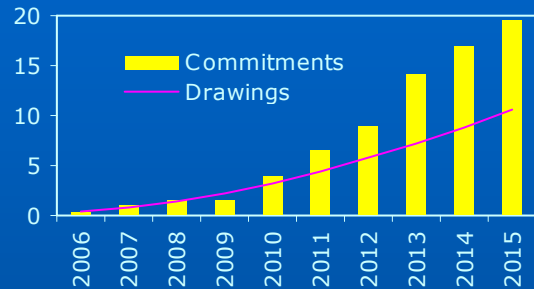
2/ Data for end of June 2006.

3/ Data for end of September 2006.

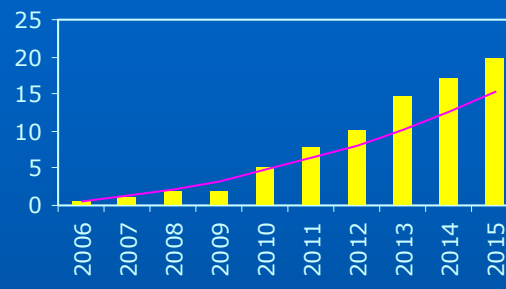
Source: Data from national authorities.

# NMS: Structural funds - EU commitments and country-specific absorption 1/ (cumulative in Euro billion)

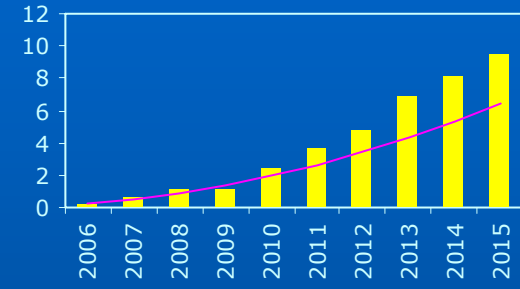
Czech Republic



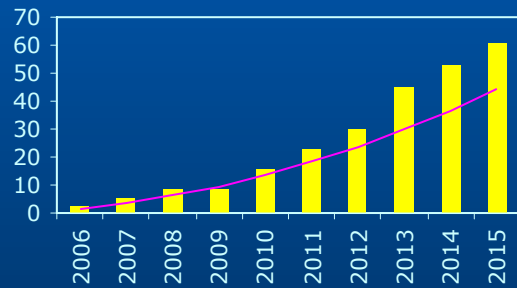
Hungary



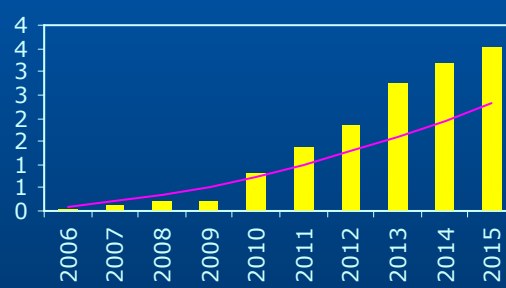
Slovakia



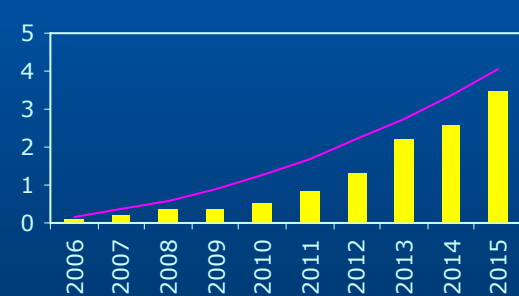
Poland



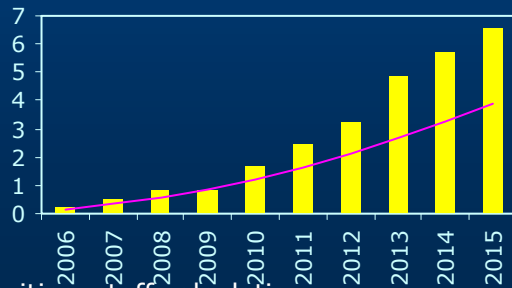
Slovenia



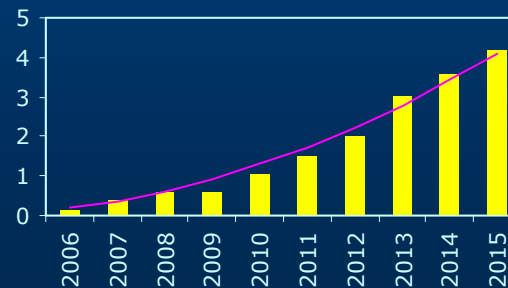
Estonia



Lithuania



Latvia



Source: EC, national authorities, staff calculation.

1/ Trend extrapolation based on drawings in 2004-06.



# Structural Funds: Could institutional frameworks explain absorption?

- NMS have developed two models:
  - BALTIC MODEL: Single institution acting as both managing and paying authority; this role is played by the Ministry of Finance
  - CE5 MODEL: MoF acting as payment institution, but not as a central managing authority
  
- Observations:
  - Leaders in absorption represent both models
  - In both cases there seem to be quite strong central coordination in management of EU funds
  - Initial frameworks were over-regulated and NMS are streamlining their regulations
  - Well-functioning payment systems and proper incentives for beneficiaries are needed to translate high contracting into high disbursements

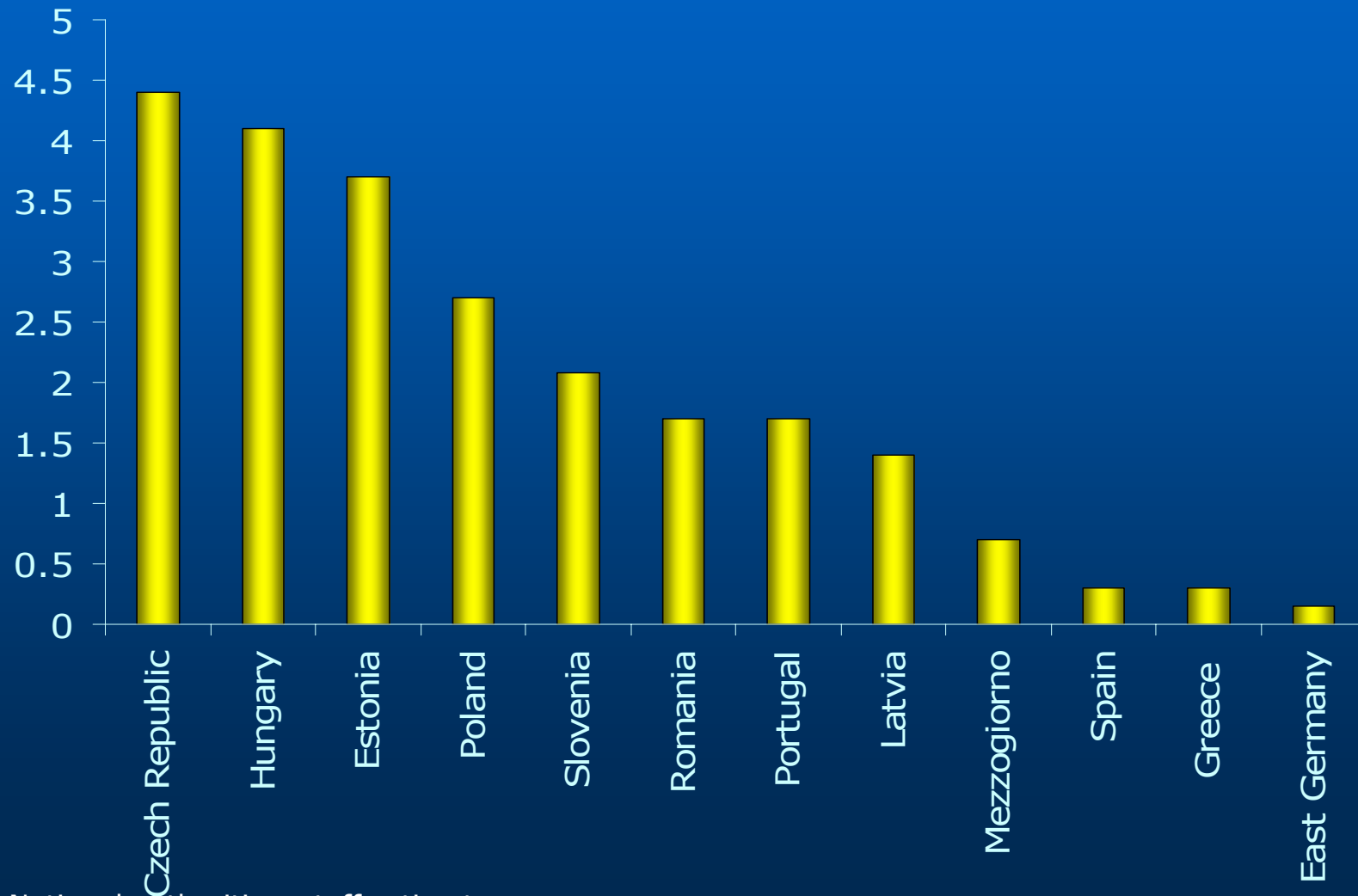
# Modeling the impact of structural funds: Methodological issues

- Defining a baseline without SF
- Calibration: rapid structural changes, few comparator countries for panel regression
- Measuring distortions caused by SF
- How to refine the concepts of stock in human capital and physical infrastructure
- Incorporating the quality of program design and implementation
- Actual vs. projected payments

# Macro models applied to the NMS

- HERMIN: First cross-country results in Bradley et al (2004), application to Poland
- QUEST: European Commission's macro model for policy analysis – application to NMS possible (done for some old member states)
- GEM: IMF micro-founded global simulation model - application to EU funds in NMS is underway.

# HERMIN: Increase in the level of GDP by 2020 (% over no-SF baseline level)



Source: National authorities, staff estimates.

# Key Messages

- Macro effects of EU funds are small to date, but are likely to grow
- Work program: develop analytical models to examine policy tradeoffs
- Policy challenges:
  - Increasing absorption
  - Avoiding unwarranted fiscal stimulus
  - Using SFs to enhance growth