

EU Funds in the New Member States:

Short-term Macro Issues



Christoph Rosenberg

International Monetary Fund

European Economic and Social Committee

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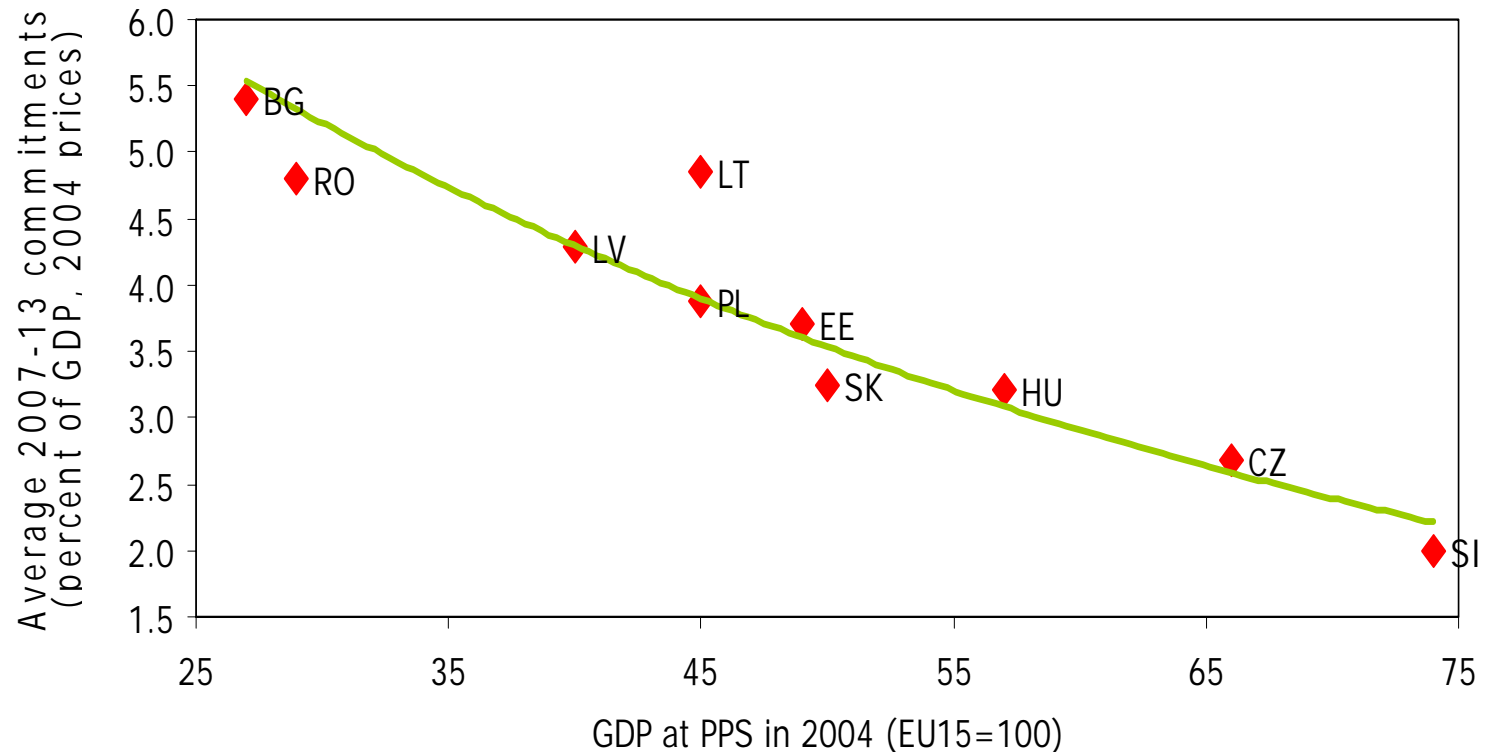
Outline

Limited focus: short-term macro impact

- EU funds available to the new member states
- Budgetary impact of EU funds
- Demand impact of EU funds to date
- Structural funds: The absorption challenge

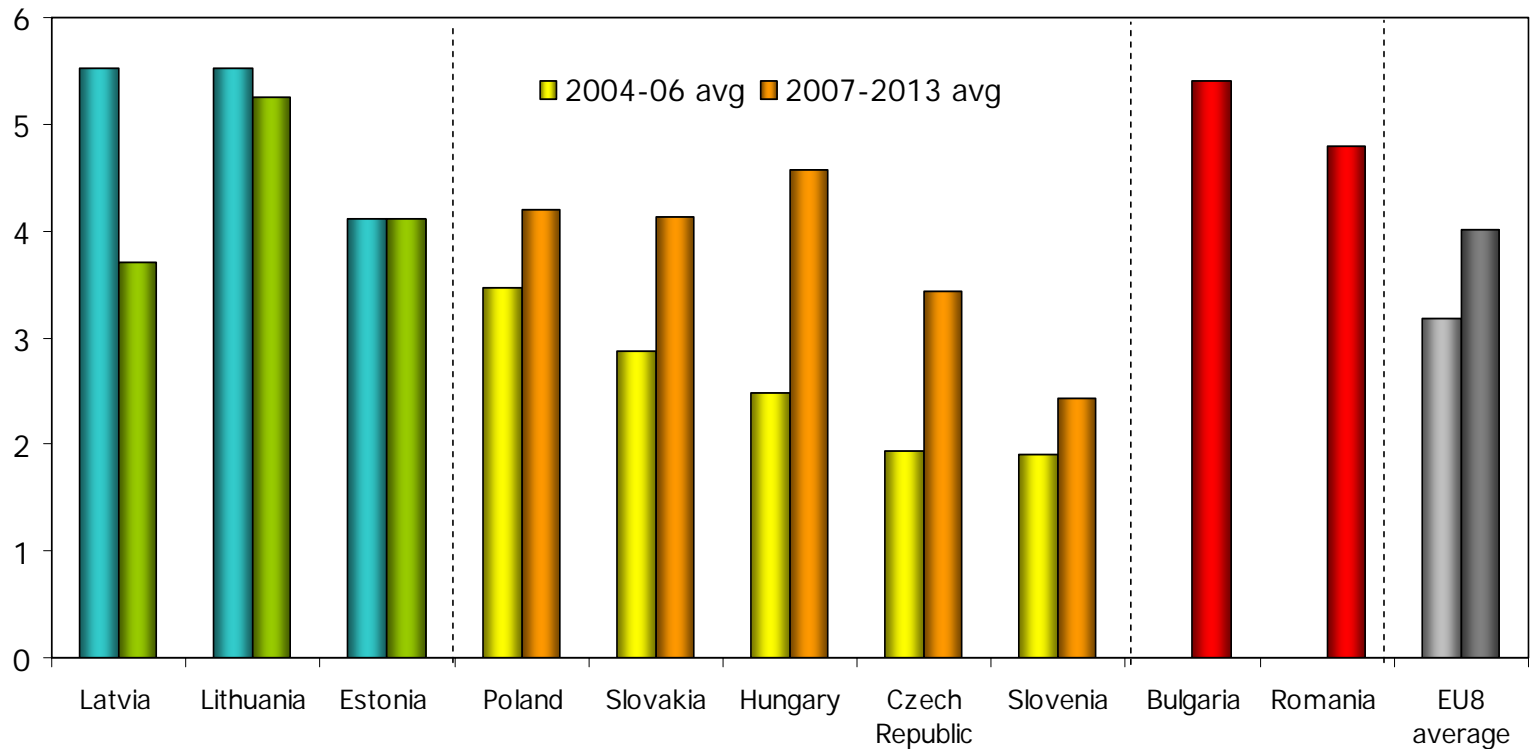
Commitments largely reflect countries' catch-up needs

NMS: Average annual EU Commitments and Real Convergence



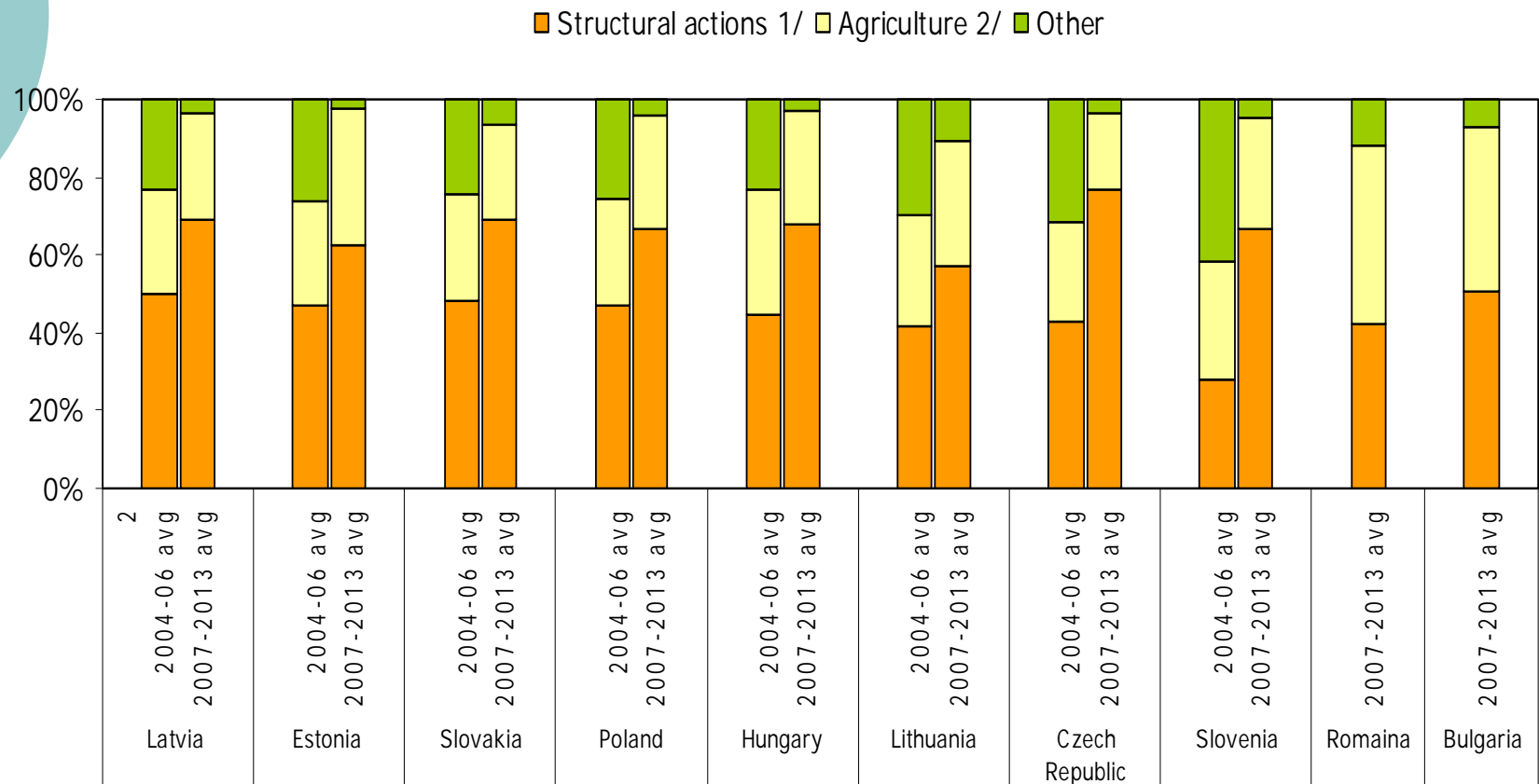
In 2007-13 the relative importance of EU funds will likely increase in Central Europe and decline in the Baltic

EU8. Average annual commitments as a percent of GDP



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

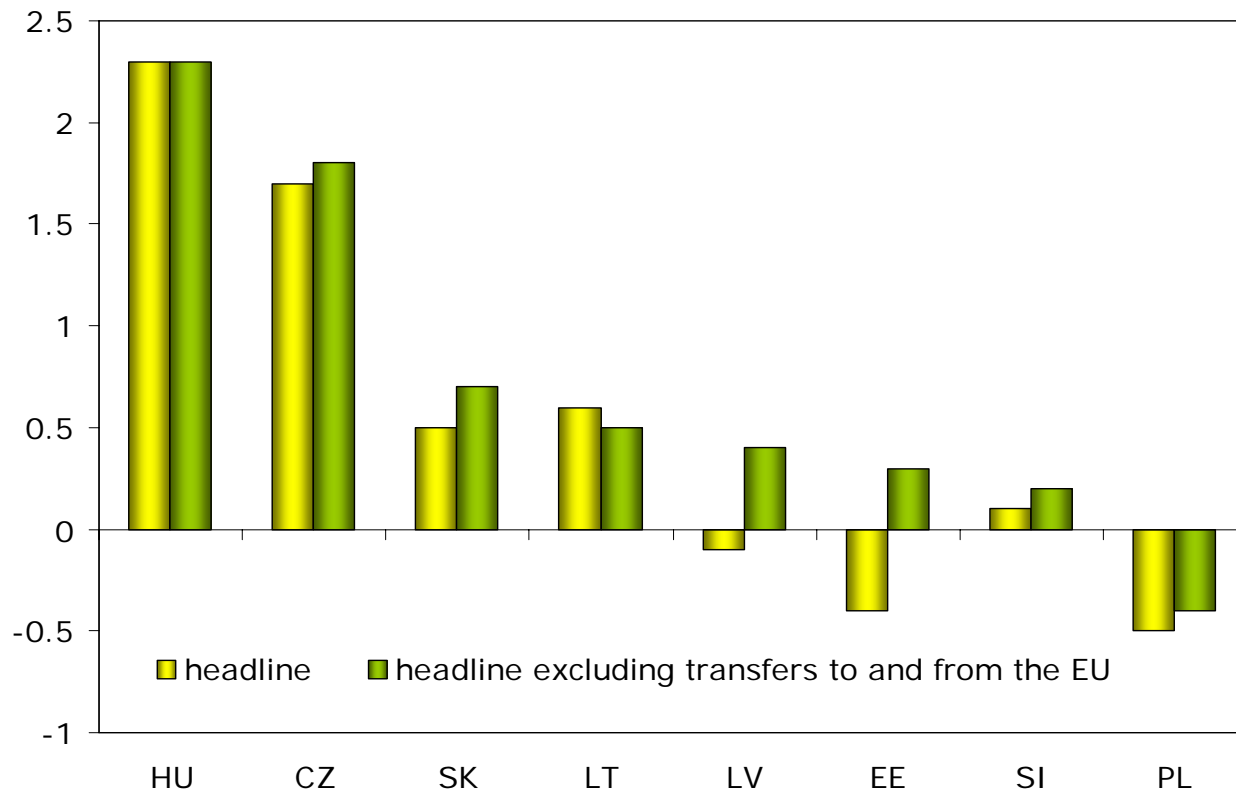
	2004 Actual	2005 Actual	2006 Estimated
(1) EU related receipts (1)	79	121	201
o/w budget compensation	43	8	8
transfers to government beneficiaries	36	113	193
(2) EU related expenditures	190	361	523
spending on EU projects/policies	36	113	193
contribution to EU	120	187	186
national co-financing	35	89	168
(3) Substituted spending 1/	45	112	215
Net fiscal impact = (1) - (2) + (3)	-67	-128	-107
(in percent of GDP)	-0.3	-0.6	-0.5

Source: National authorities, staff estimates.

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

EU funds can make fiscal policy more procyclical if net inflows are positive

Fiscal stimulus (percent of GDP, 2006)



Fiscal impact: Policy challenges

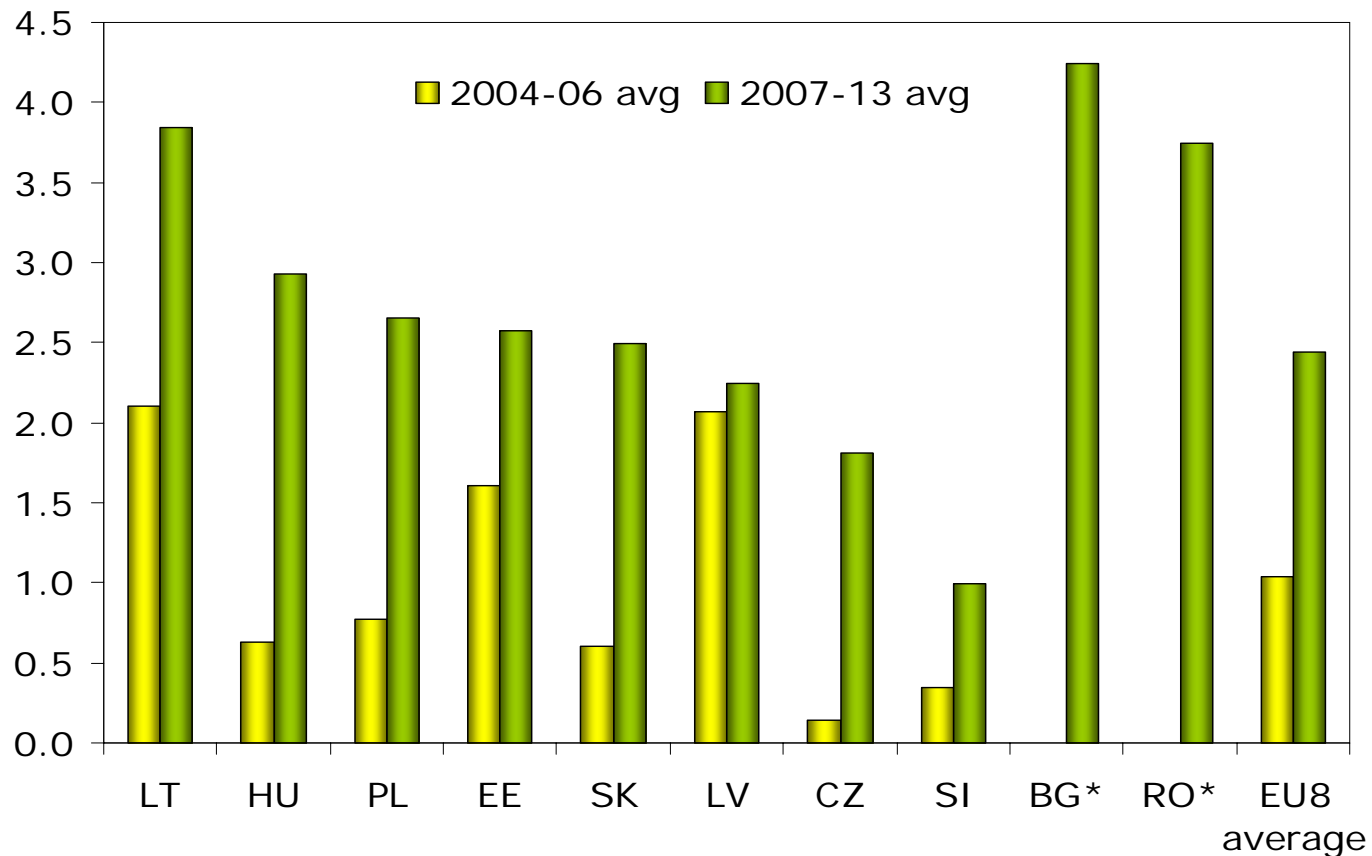
- Reduce the negative impact on already excessive deficits (Central Europe)
- Reduce hidden fiscal impulse (Baltics)

By:

- Reducing current spending elsewhere in the budget
 - Redirecting SF spending away from overheating sectors (e.g., construction)
 - 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

Net inflows of EU funds
(percent of GDP, current prices)



Source: National authorities, staff estimates.

*Data on preaccession aid are not available.



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: depend on consumption propensities
- Second round and general equilibrium effects

Demand impact: 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

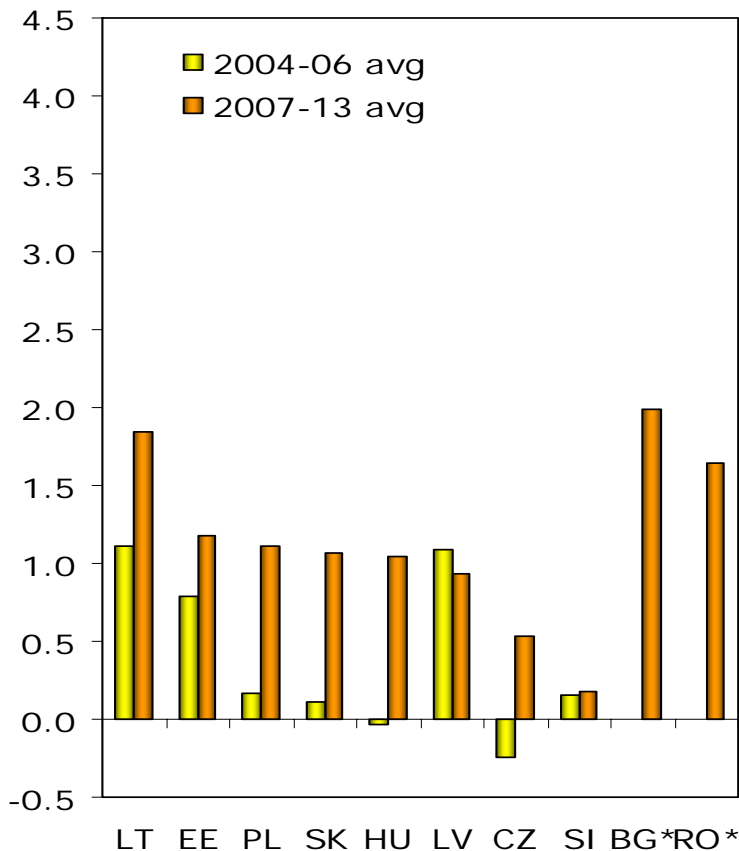
C - contributions paid to EU

A - advances received

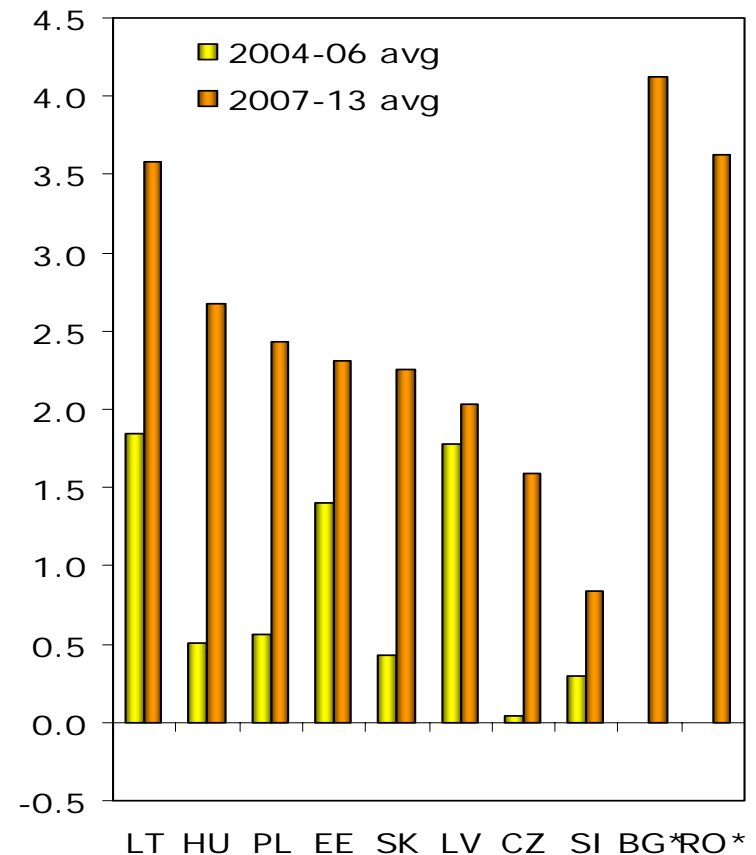
α - degree of substitution between EU- related projects and domestic spending that would have happened anyway (depending on the implementation of additionality guidelines)

First round effect on demand depends on additionality assumptions

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

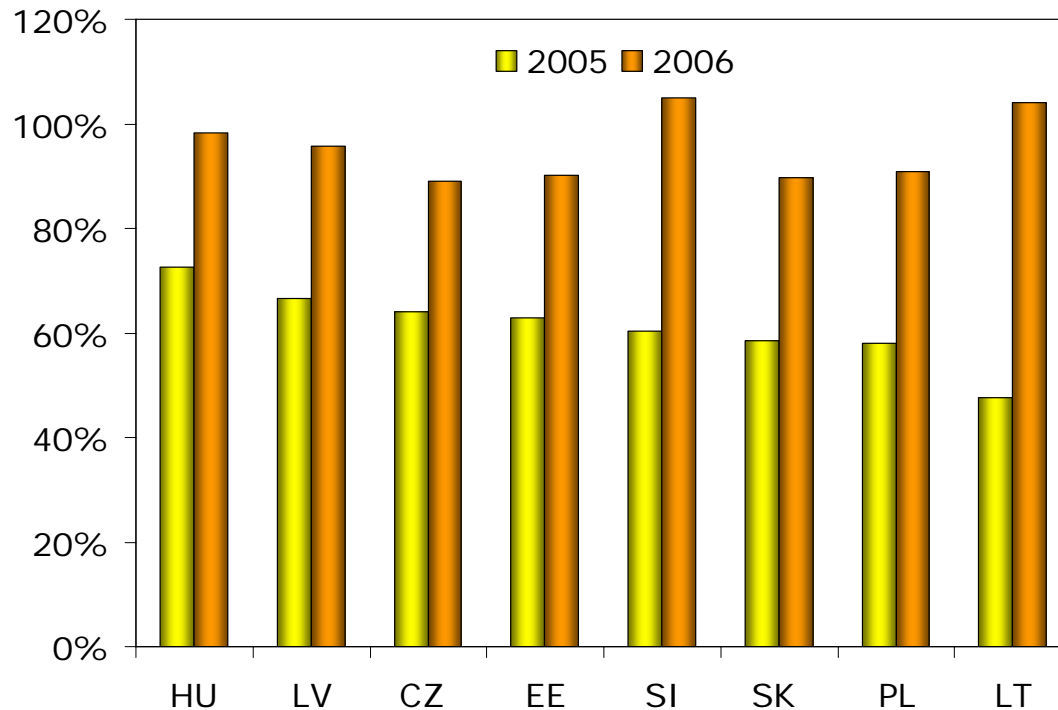


Full additionality
($\alpha = 1$)



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

Contracting of structural funds
(percent of 2004-06 commitments)



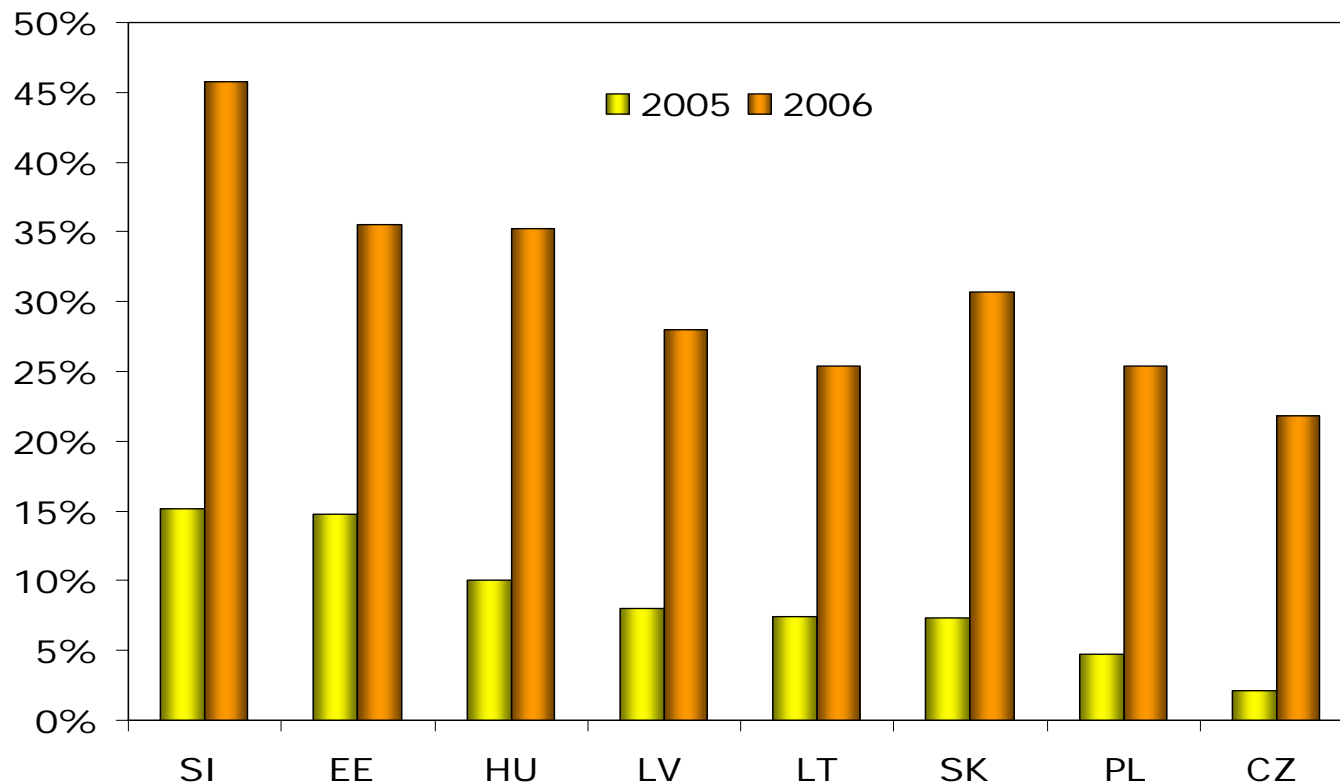
1/ Data for end of September 2006.

2/ Data for end of June 2006.

Source: Data from national authorities.

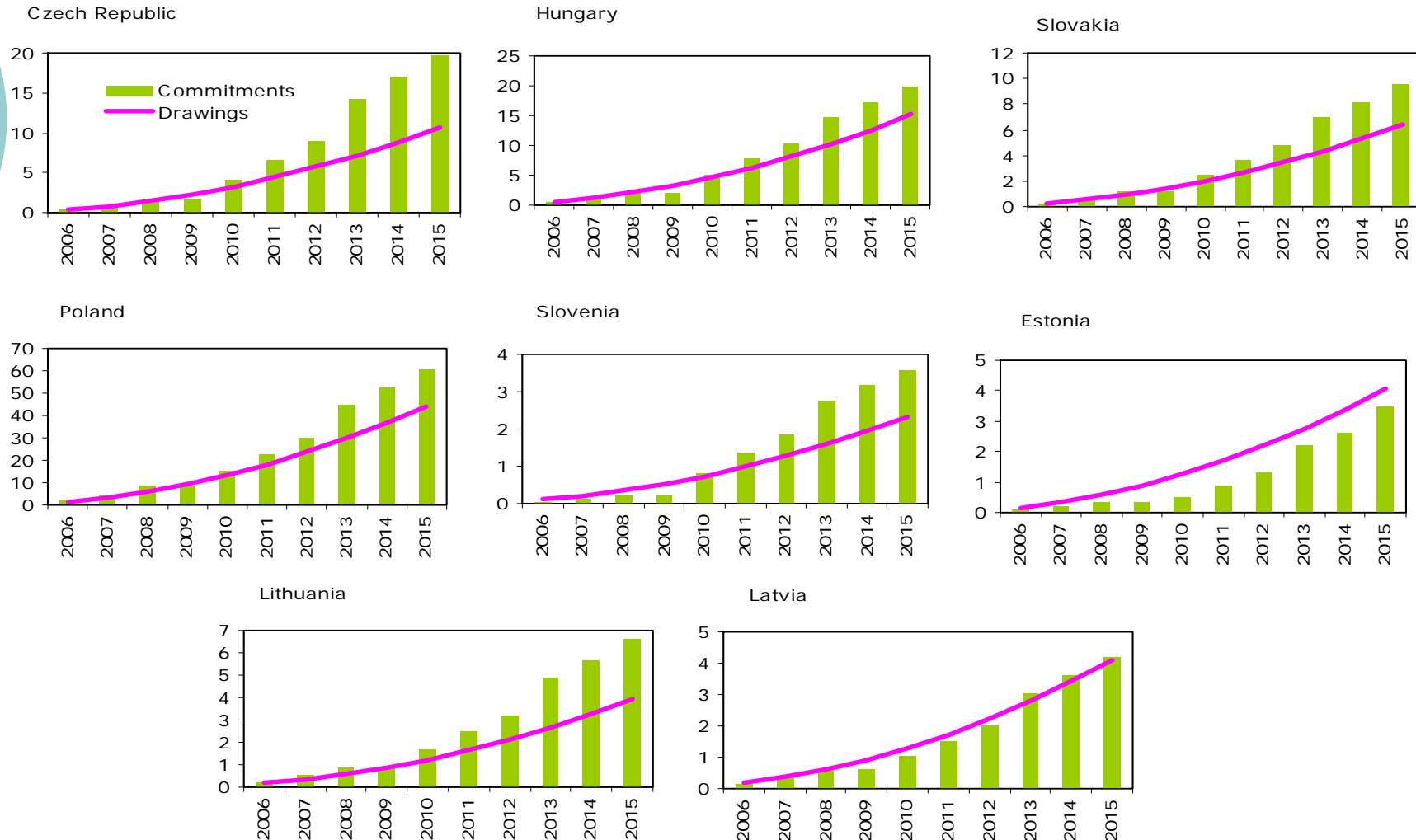
...but absorption rates differ

Requests for interim payments
(percent of 2004-06 commitments)



The absorption challenge differs as well

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



Source: EC, national authorities, staff calculation.

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

Key Messages

- Macro effects of EU funds are small to date, but are likely to grow substantially
- Policy challenges:
 - Increasing absorption
 - Avoiding unwarranted fiscal stimulus
 - Using SFs to enhance growth
- Work program: develop further analytical models to examine policy tradeoffs (QUEST, ECOMOD, HERMIN, GIMF) –see the EC's recent Cohesion Report