EU Funds in the New Member States: *Short-term Macro Issues*

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European Economic and Social Committee
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Based on C. Rosenberg, R. Sierhej Interpreting EU Funds Data for Macroeconomic Analysis in the New Member States, IMF WP 77/07, available at www.imf.org/cee
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

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

- Structural actions 1/
- Agriculture 2/
- Other

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

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

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)

Source: Christoph B. Rosenberg and Robert Sierhej, Interpreting EU Funds Data for Macro Analysis in the New Member States, IMF Working Paper (forthcoming)
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

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

- **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
\( (\alpha = 1) \)

Source: National authorities, staff estimates.
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.
Source: Data from national authorities.
...but absorption rates differ

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

Source: Data from national authorities.
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.