

# EU Funds in the New Member States:

## *Short-term Macro Issues*

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Brussels, June 21, 2006



# Outline

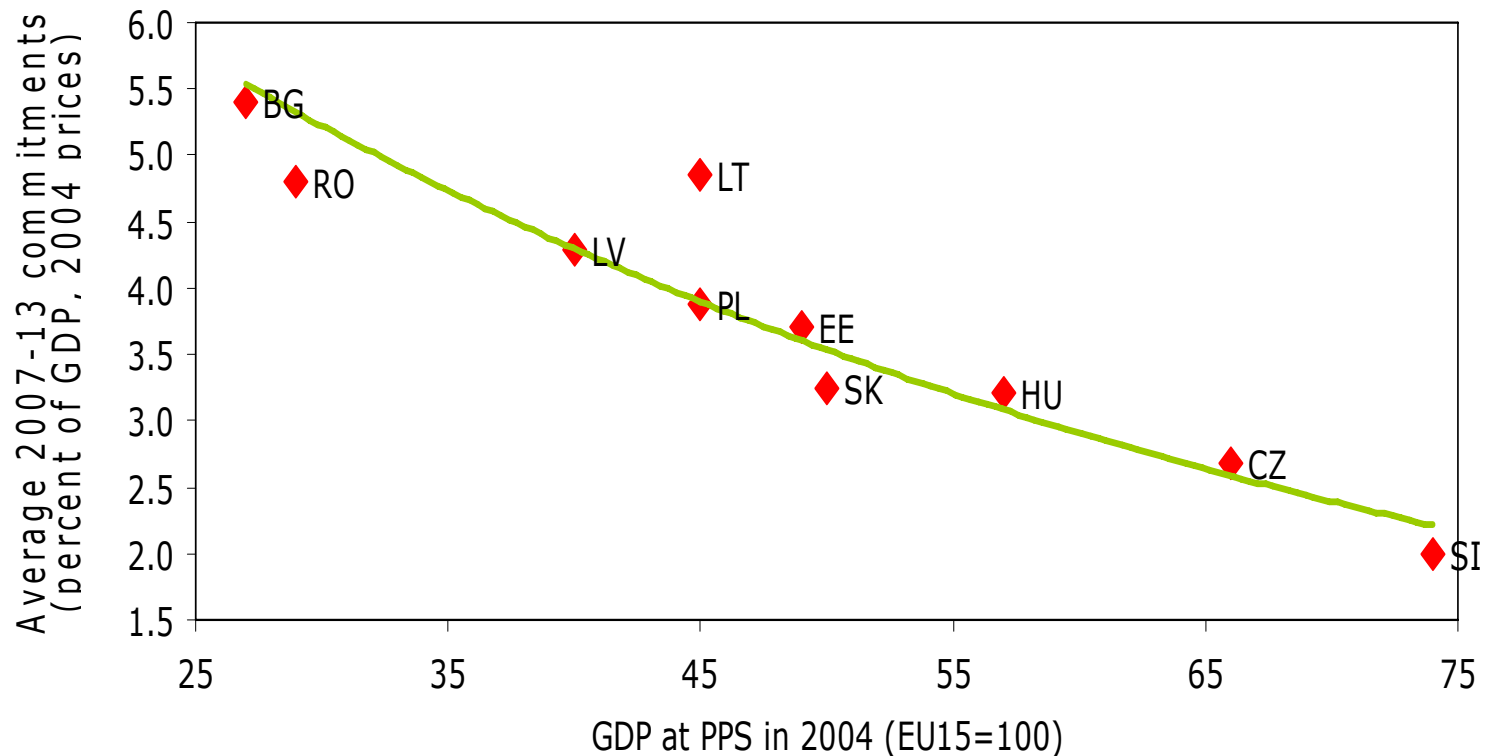
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Limited focus: short-term macro impact

- 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

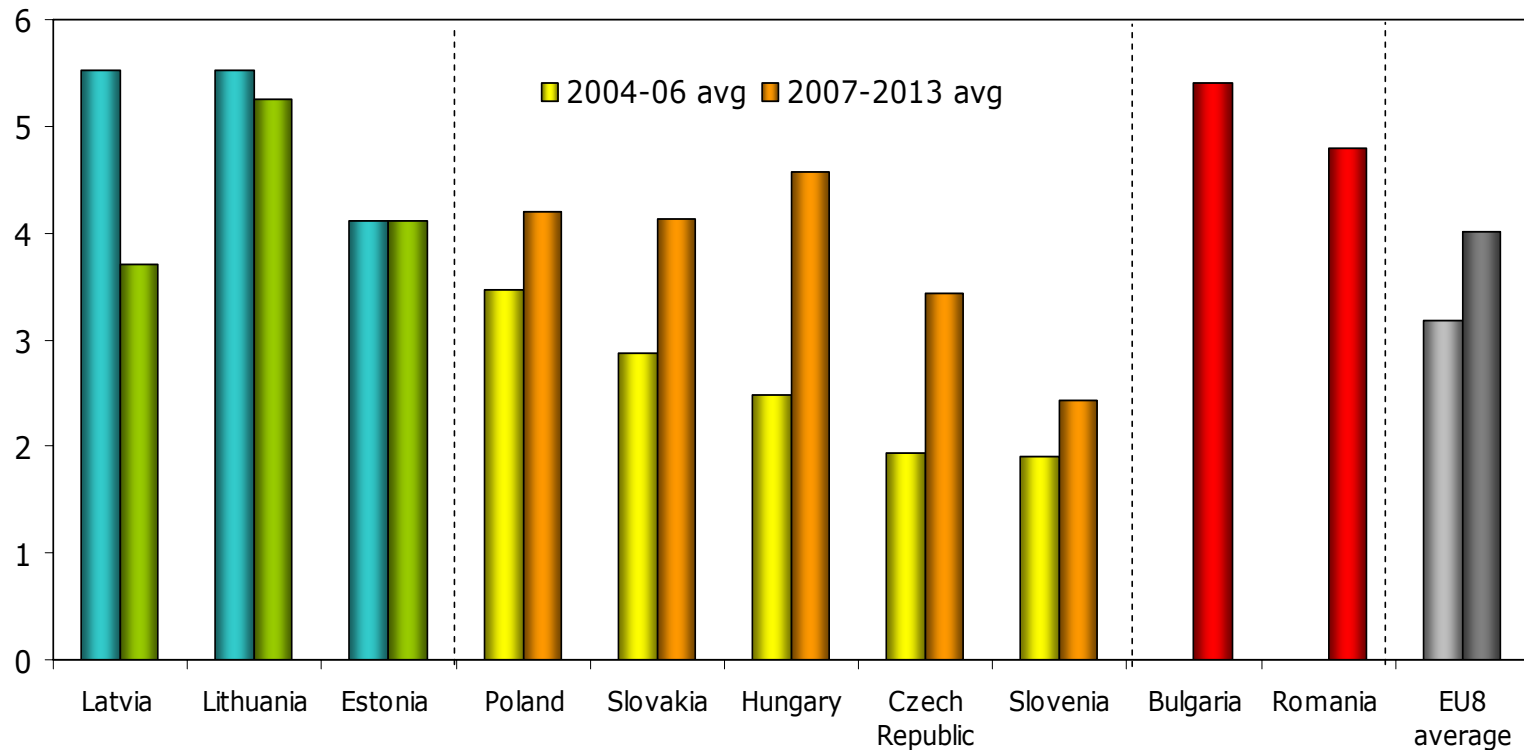
# Commitments largely reflect countries' catch-up needs

## 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

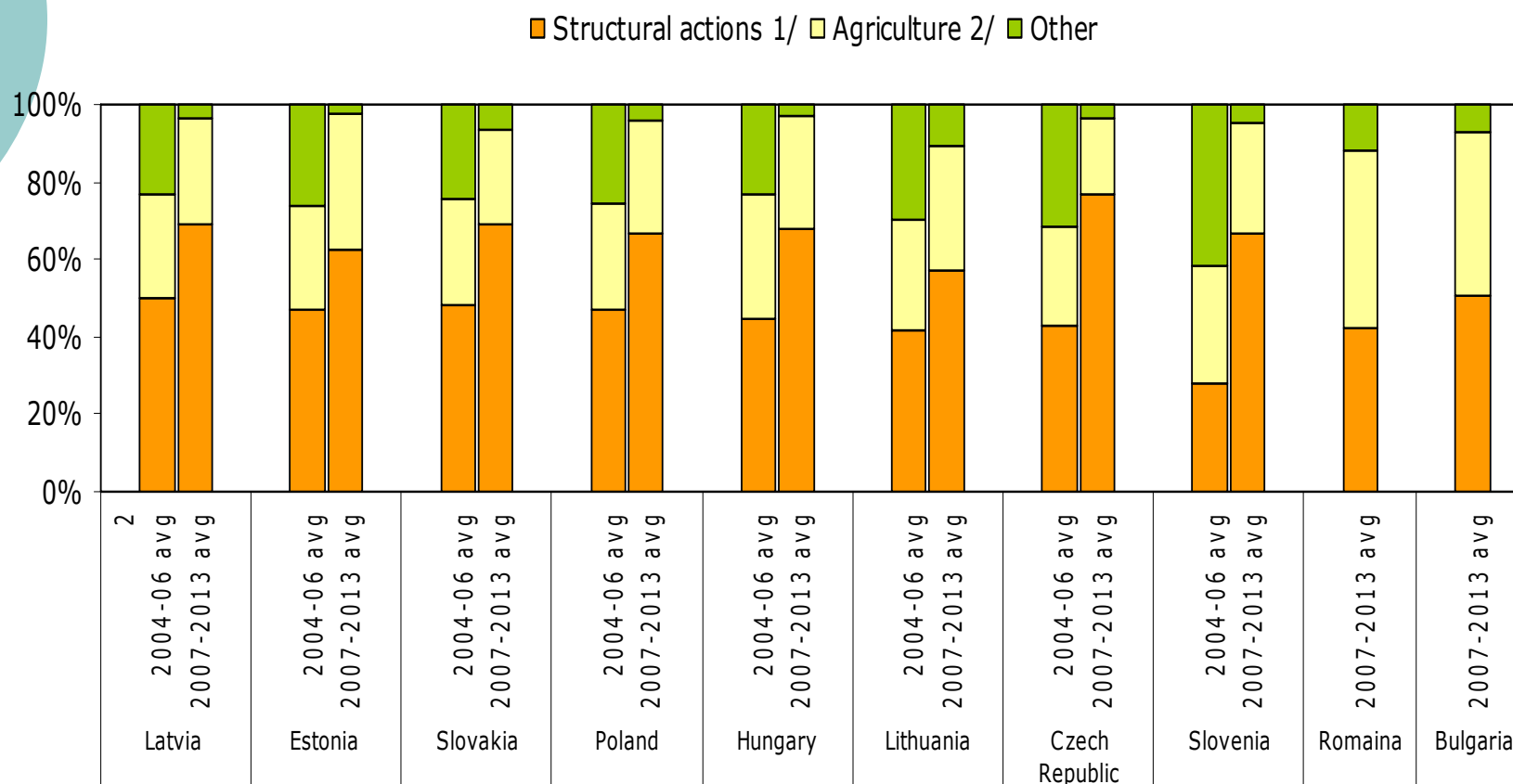
## EU8. Average annual commitments as a percent of GDP



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

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## **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

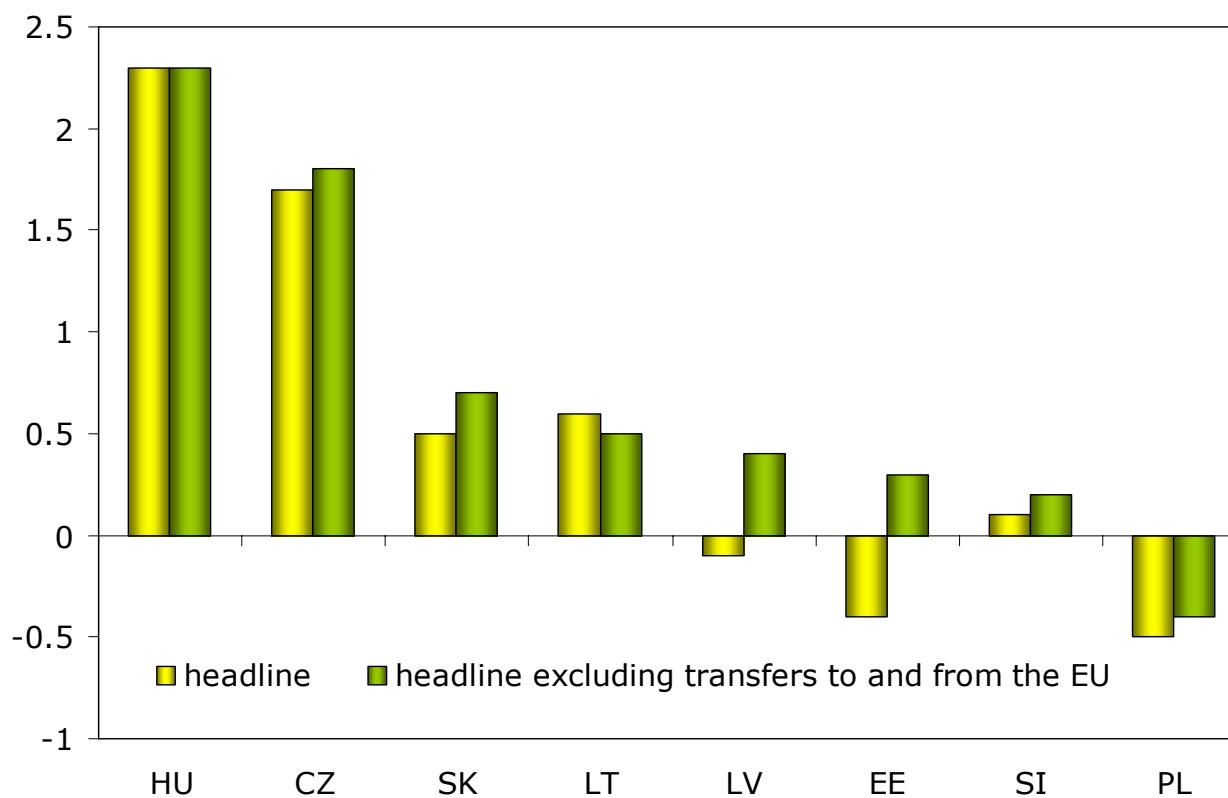
	<b>2004 Actual</b>	<b>2005 Actual</b>	<b>2006 Estimated</b>
<b>(1) EU related receipts (1)</b>	<b>79</b>	<b>121</b>	<b>201</b>
o/w budget compensation	43	8	8
transfers to government beneficiaries	36	113	193
<b>(2) EU related expenditures</b>	<b>190</b>	<b>361</b>	<b>523</b>
spending on EU projects/policies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

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

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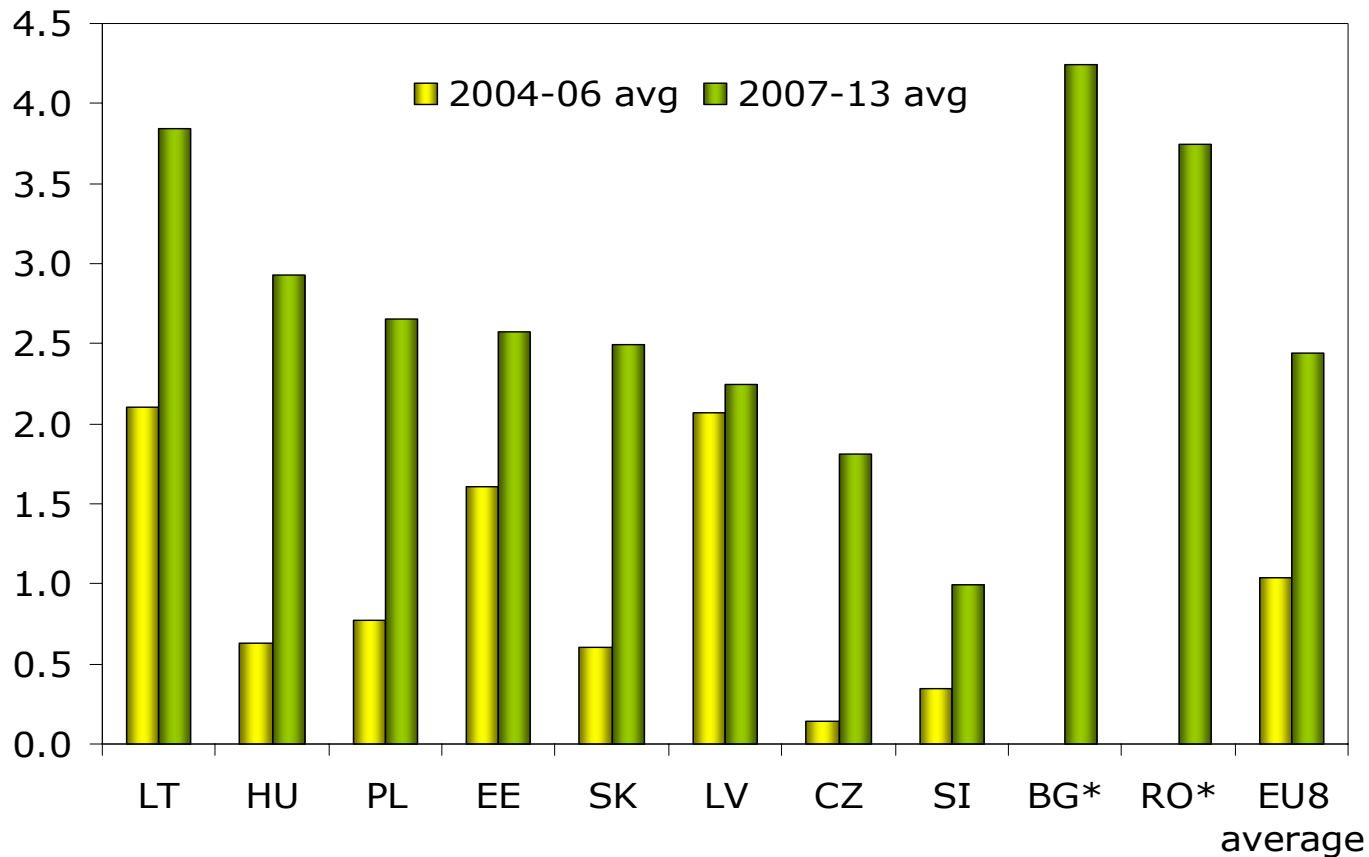
- Reduce the negative impact on already excessive deficits (Central Europe)
- Reduce hidden fiscal impulse (Baltics)

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

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- 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

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

D - demand impact

T - transfers received to EU

NC - national co-financing of EU funds

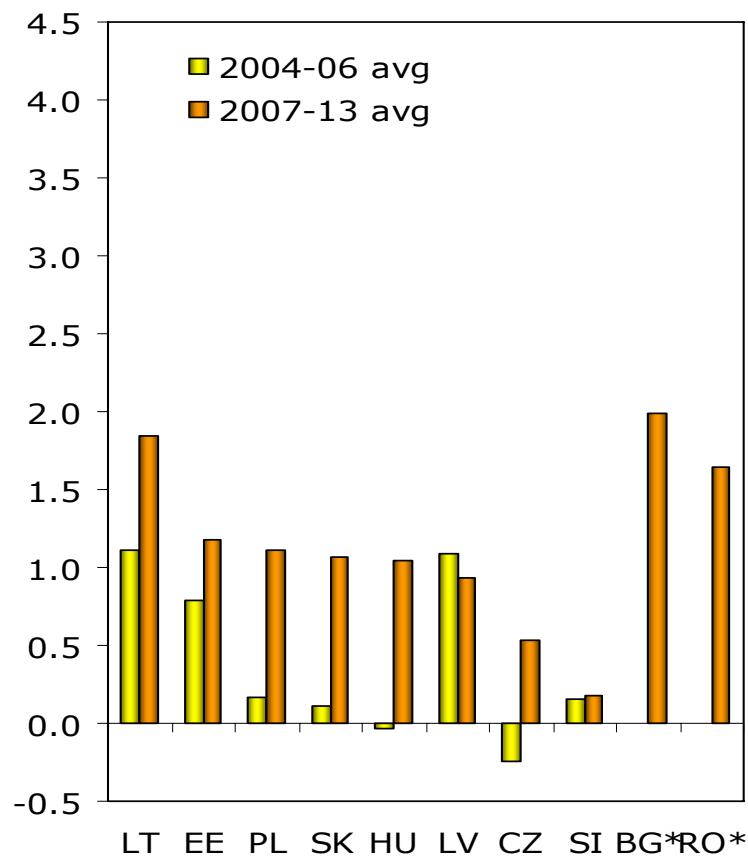
C - contributions paid to EU

A - advances received

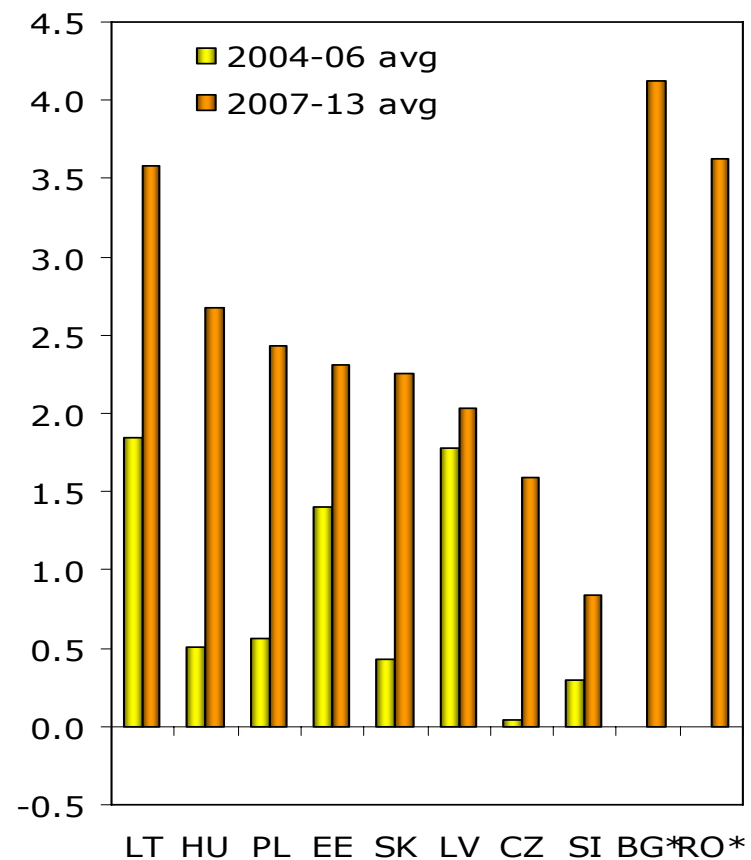
$\alpha$  - degree of substitution between EU- related projects and domestic spending that would have happened anyway (depending on the implementation of additionality guidelines)

# First round effect on demand depends on additionality assumptions

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



Full additionality  
( $\alpha = 1$ )

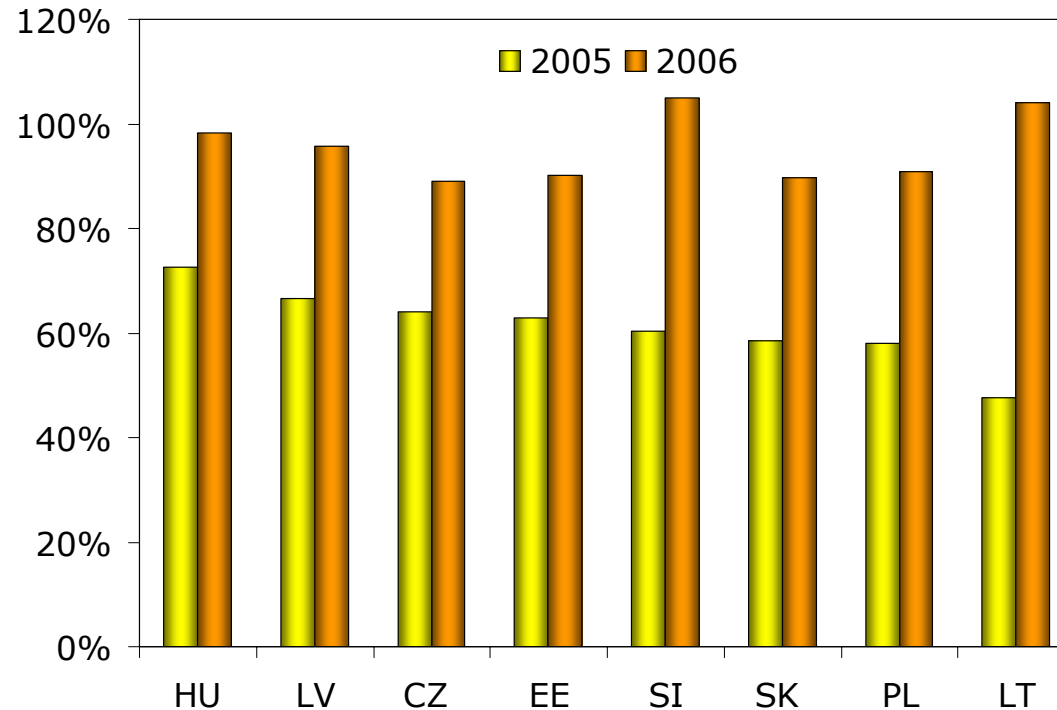


Source: National authorities, staff estimates.

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

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



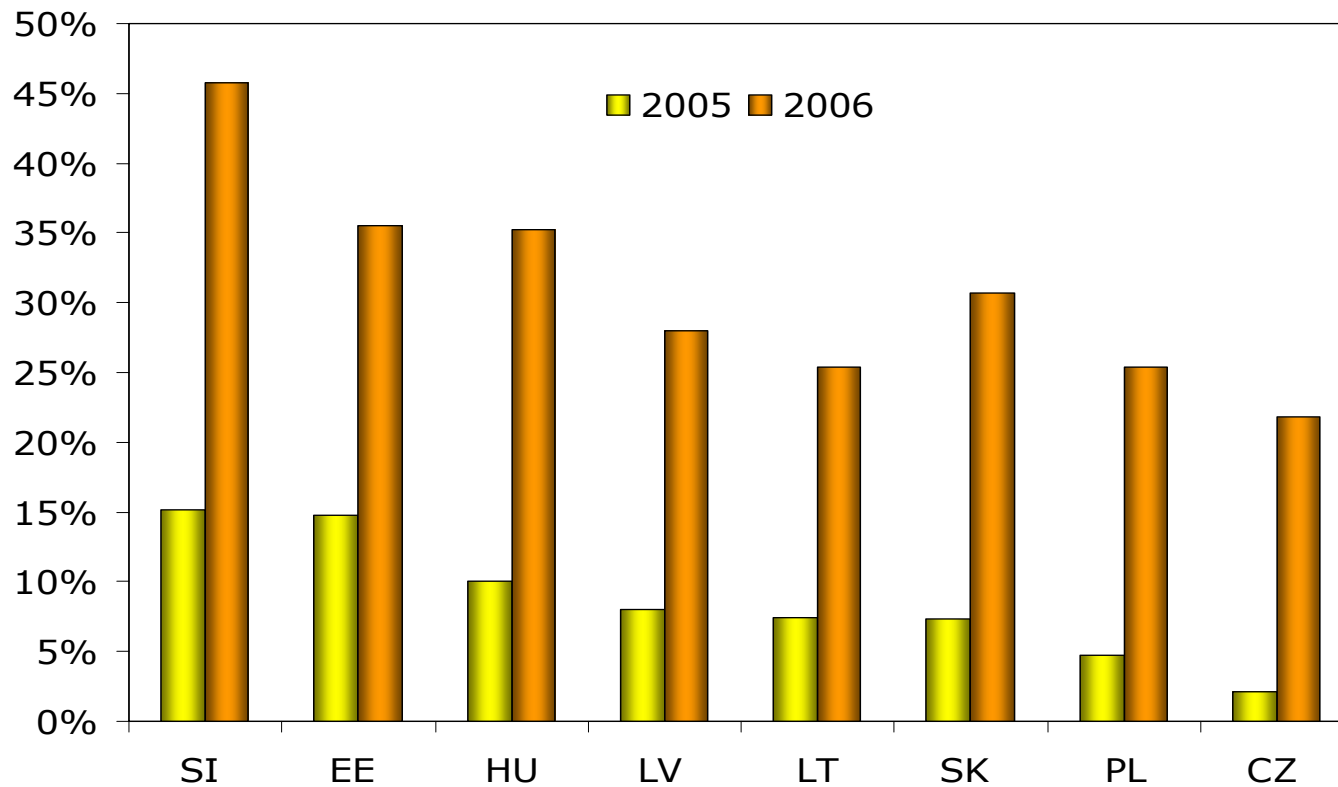
1/ Data for end of September 2006.

2/ Data for end of June 2006.

Source: Data from national authorities.

## ...but absorption rates differ

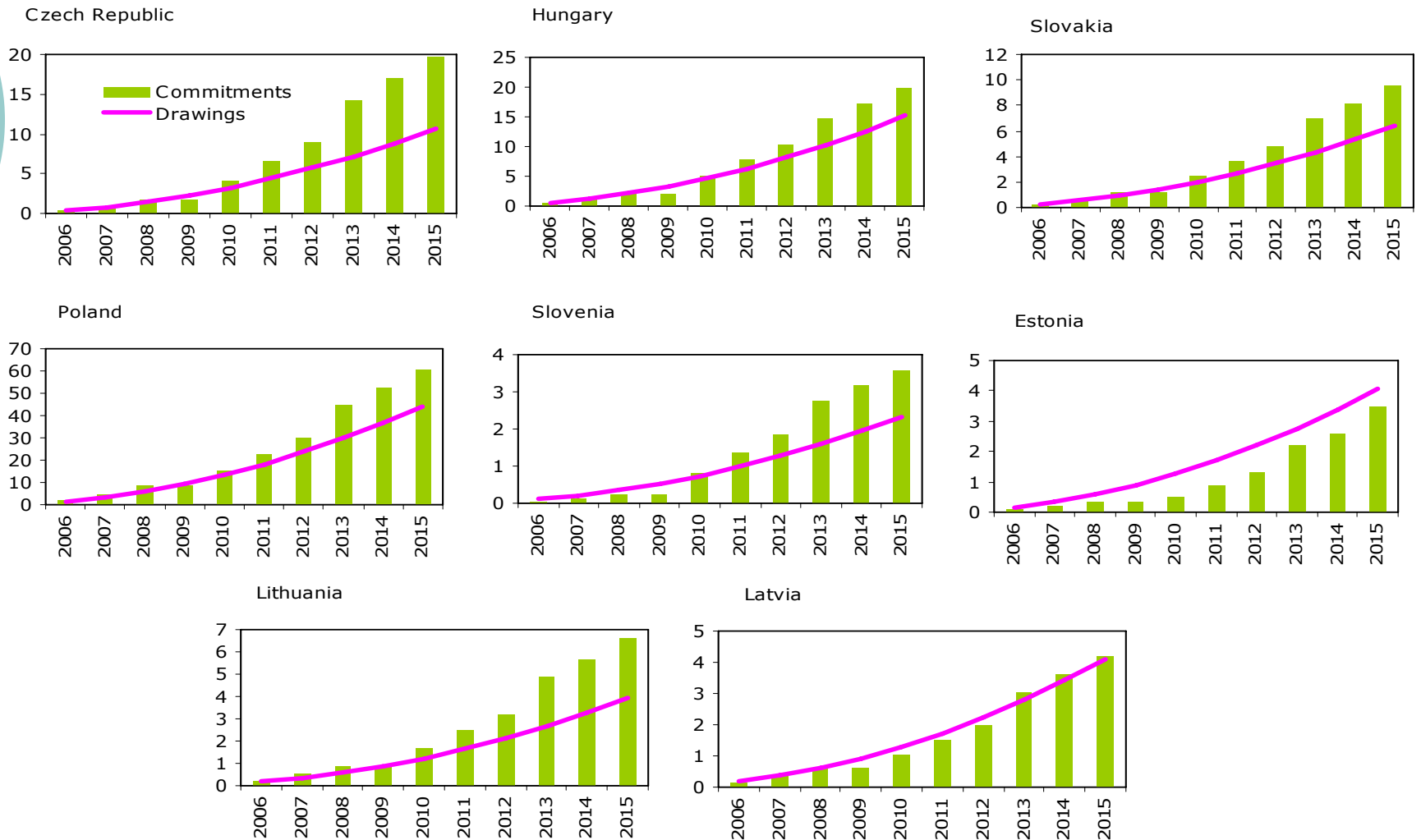
Requests for interim payments  
(percent of 2004-06 commitments)



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

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- 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