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)*

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Croatia</td>
<td>138.5</td>
<td>146</td>
<td>151.2</td>
<td>436</td>
</tr>
<tr>
<td>Macedonia, FYR</td>
<td>59</td>
<td>70</td>
<td>82</td>
<td>211</td>
</tr>
<tr>
<td>Albania</td>
<td>61</td>
<td>71</td>
<td>81</td>
<td>213</td>
</tr>
<tr>
<td>Bosnia &amp; Herzegovina</td>
<td>62</td>
<td>75</td>
<td>89</td>
<td>226</td>
</tr>
<tr>
<td>Montenegro</td>
<td>31</td>
<td>33</td>
<td>33</td>
<td>97</td>
</tr>
<tr>
<td>Serbia</td>
<td>187</td>
<td>191</td>
<td>195</td>
<td>572</td>
</tr>
<tr>
<td>Kosovo</td>
<td>63</td>
<td>65</td>
<td>66</td>
<td>194</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>463</strong></td>
<td><strong>504</strong></td>
<td><strong>546</strong></td>
<td><strong>1513</strong></td>
</tr>
</tbody>
</table>

Source: European Commission (EC).
While IPA is lower than pre-accession in the NMS...
...its economic significance is broadly comparable

IPA and pre accession assistance in NMS (commitments in percent of GDP)

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:

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

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

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

Source: MoF, staff estimates
Demand impact: A very simplified approach

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

- **D** - demand impact
- **T** - transfers received from EU
- **NC** - national co-financing of EU funds
- **C** - contributions paid to EU
- **A** - advances received
- **\( \alpha \)** - 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.
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.