



EU FUNDS – the key to future prosperity?

Presentation of the paper *ECONOMIC CONSEQUENCES OF EU FUNDS IN THE CZECH REPUBLIC - BONANZA OR MONEY HOLE?*

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EU funds – official mission

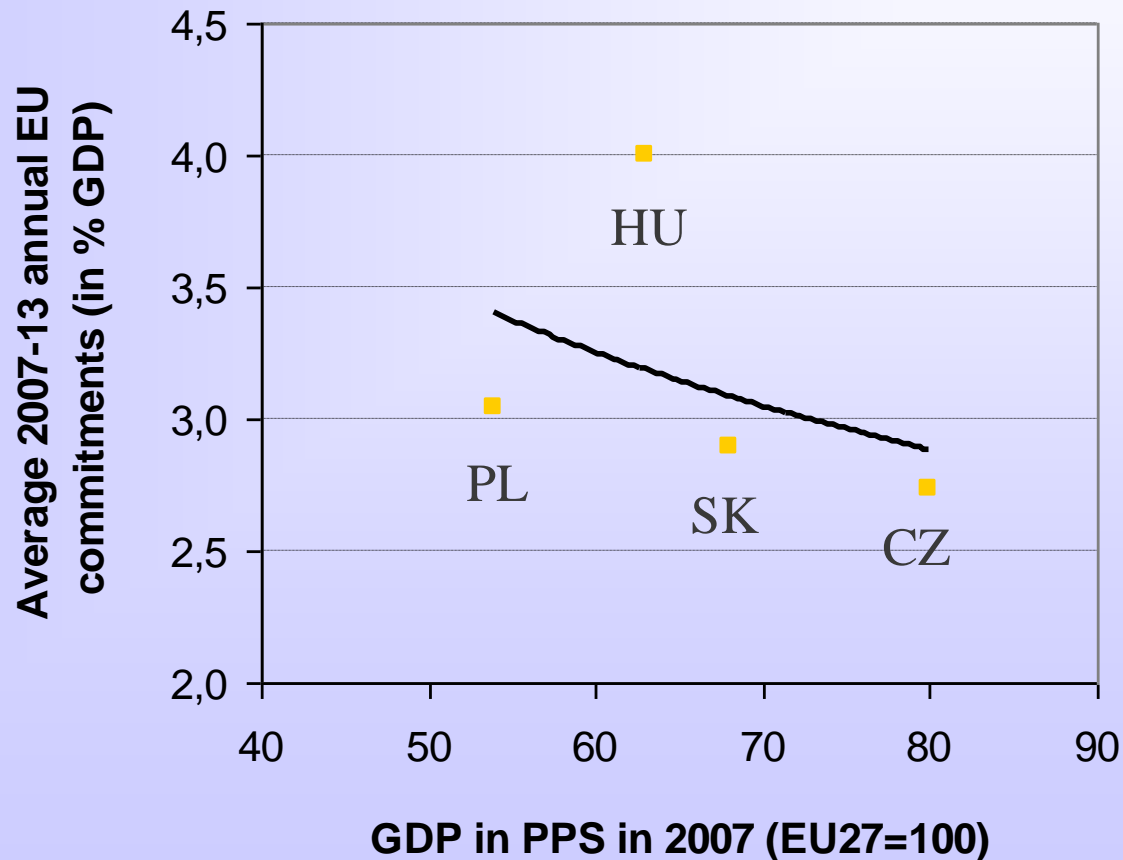
‘Cohesion policy is one of the European Union's most visible policies. All 27 EU countries benefit from cohesion policy through its three funds - the European Regional Development Fund, the Cohesion Fund and the European Social Fund – to:

- ◆ **reduce economic disparities**
- ◆ **develop competitive, diversified regional economies**
- ◆ **boost sustainable growth and jobs...’**

Source: European Commission,
http://ec.europa.eu/regional_policy/impact/index_en.cfm. Sept 2011.

EU funds vs. real convergence

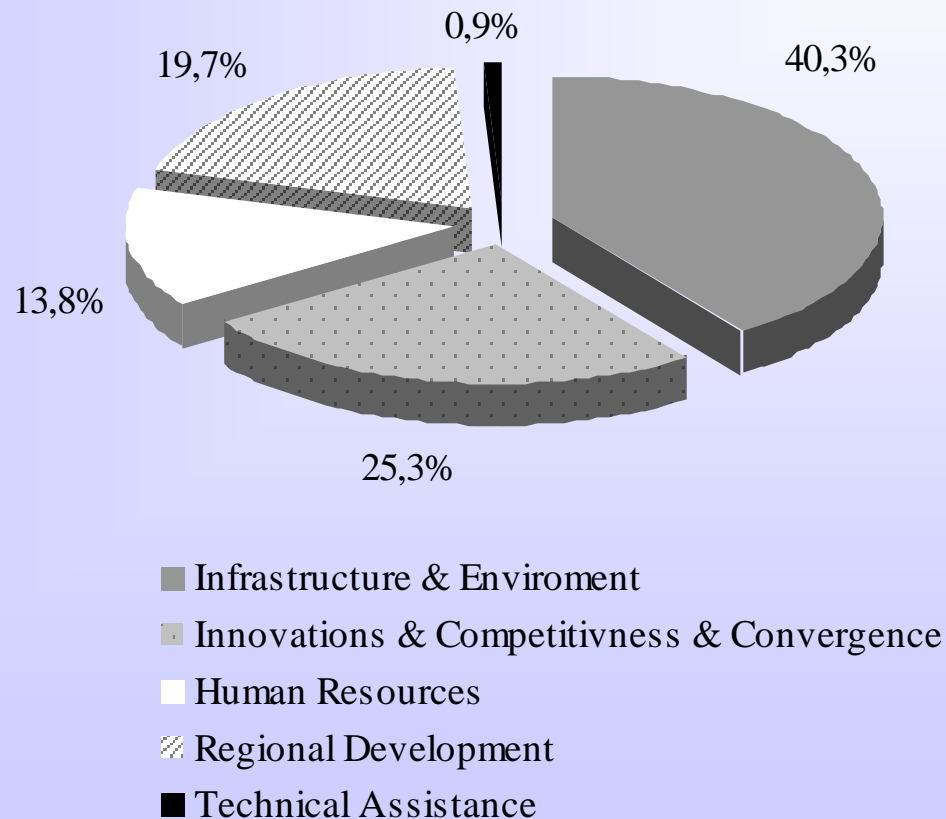
The richer the country, the smaller the amount of EU transfers is in relation to a country's GDP ...



Source: Own calculation, June 2010.

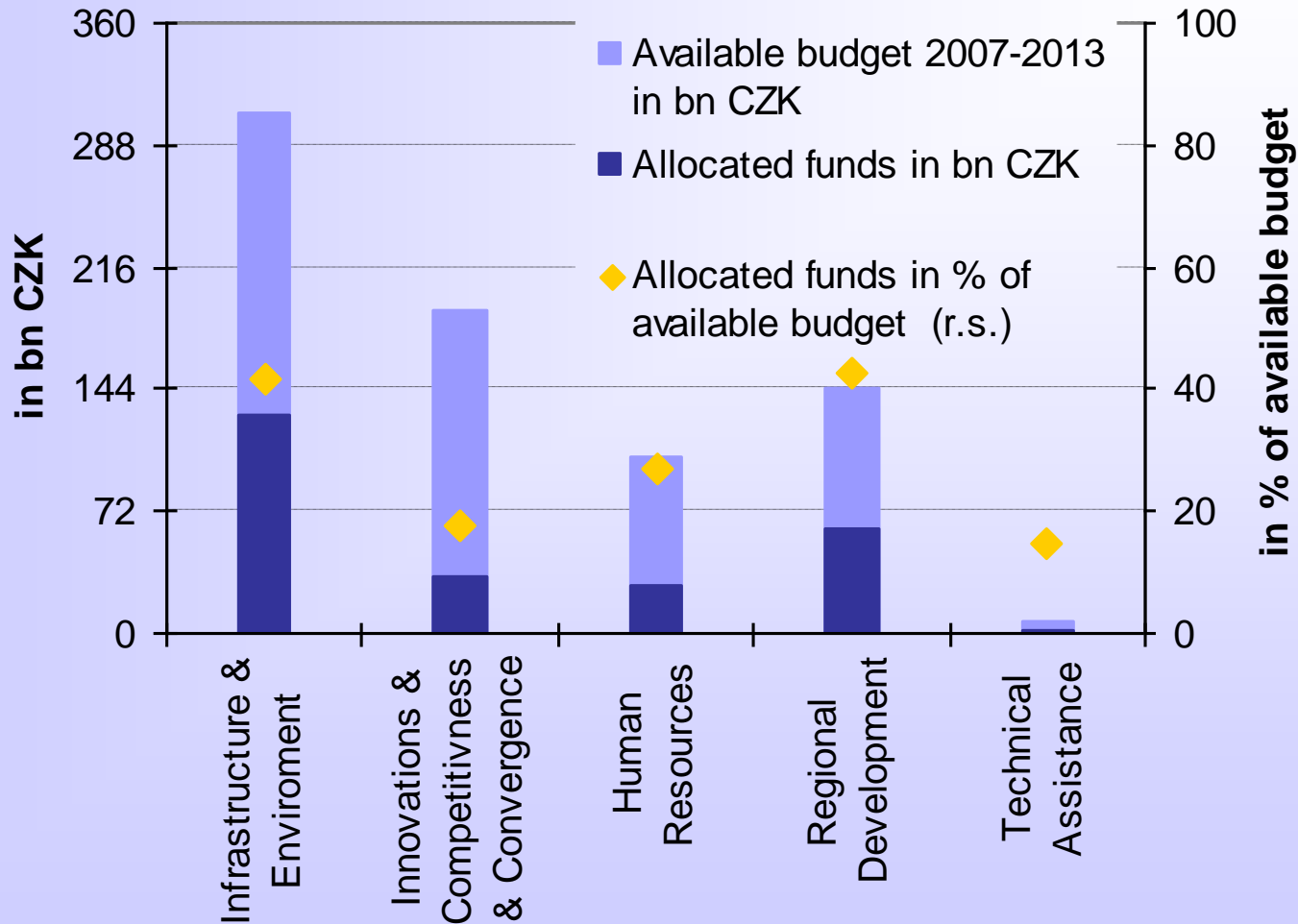
EU funds in the CR

Infrastructure is the winner



Source: Own calculation based on NOK-MMR data, Aug 2011.

Drawings still behind the curve



Source: Own calculation based on NOK-MMR data, Aug 2011.



What are the theoretical effects of EU funds?

- ◆ **Demand-side effects:** expenditure multipliers
- ◆ **Supply-side effects:** improved infrastructure, technological diffusion, boosted innovation and improved human capital enhance production capacity and productivity
- ◆ **2nd round effects** on LT economic growth due to positive externalities of investment into infrastructure and human capital or synergy effect of merged national and international capital that increases the quality and profitability of the investment



What could we expect?

**Effects of EU transfers on GDP and employment in 2015
(percentage gains)**

	GDP gain	Employment gain
	(% above baseline)	
CZ	9,1	7,1
PL	5,4	2,8
HU	5,4	3,7
SK	6,1	4

Source: European Commission (2007) adapted from IMF, April 2010.

Is it not only wishful thinking?



Alternative estimations

Alternative estimations are less ‘enthusiastic’ regarding economic gains of EU funds:

E.g. Rosenberg (2007): + 0,5pp in annual average nominal GDP growth over spending period in the CR; in Poland & Hungary + 1pp gain.



Why are the estimations so different?

- ◆ Great uncertainties
- ◆ Different applied methods
- ◆ Different underlying assumptions incl. crowding-out effects and positive externalities (or spillover effects)

Crowding-out effects:

- (1) crowding-out of current public and private expenditures
- (2) increase in savings rate
- (3) excessive real appreciation of the currency



Reality of the Czech Republic

- ◆ Absorption of EU funds has recently accelerated (to 32% of total available budget in mid-2011)
- ◆ **Short-term (demand) effects: +1pp** of nominal GDP in 2009 (multiplier 0.6); more than **+ 1.5pp** in 2010, in 2011 might again exceed 1pp
- ◆ **Long-term (pro-growth) effects** face various potential leakages:
 - Low multiplier of costly traffic projects & nonnegligible import propensity of projects
 - High share of beneficiaries from public sector (more than 80%) – less effective & corruption failure
 - Ongoing fiscal consolidation → crowding-out of current public expenditures and private investments
 - Additional pressure on CZK appreciation



Leakages in the CR in more details

- ◆ National co-financing (15%) might weaken the fiscal balance by CZK 100-130bn with annual contribution in tens of billions; in the case of the acceleration in absorbing of EU funds more than CZK 30bn \Rightarrow **crowding-out of public expenditures**, more painful fiscal consolidation
Generally, IMF (2007) estimates crowding-out factor between 0.55-0.65.
- ◆ Net inflow of EU funds exceeded 1% of nom. GDP (or CZK 40bn) in 2010; but it might exceed 3% of nom. GDP in a single year if the CR accelerates spending;
BUT FDI inflow eased off – the EU funds might offset their drop and help sustain the CZK's LT appreciation trend



Political implications: NEW GROWTH MODEL

- ◆ Annual inflow of EU funds 2.7% of nom. GDP contra 5 % in the case of FDI inflow in terms of nom.GDP in the period 2004-2007
 - ◆ The pro-growth effects of EU funds couldn't be similar to the FDI ones
 - ◆ But the CR can't further count on a further strong FDI inflow
- ⇒ New growth model based on higher value added production, productive service sector, knowledge and innovation.



Source:

- ◆ Allard, C., Choueiri, M., Schadler S. A Van Elkan, R. “Macroeconomic Effects of EU transfers in New Member States“. *IMF Working Paper*, 2008, No. 08/233.
- ◆ OECD. “Importance of the support from EU funds“. *OECD Economic Survey of Poland*. OECD, April 2010.
- ◆ National Coordination Authority. “Monthly Monitoring Report on the Course of Drawing from the Structural Funds, the Cohesion Fund and National Resources in the program period of 2007-2013”. different issues. *Ministry for Regional Development Czech Republic*, 2008-2010.
- ◆ Raiffeisen Research. “Strategy Czech Republic“. July 2010. *Raiffesen Research*. <http://www.rb.cz/attachements/pdf/analyzy/strategy-cz.pdf>.

THANKS FOR ATTENTION!