EUROPEAN COMMISSION
DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS
Economies of the Member States

Public Investment, Catching up and the EU Fiscal Policy Framework

Filip Keereman*

Head of Unit – Czech Republic, Poland, Romania and Slovakia

Brussels, 14 May 2008
ICEG EC Conference on “Growth Patterns and Capital Formation in the Eastern EU Member States”

***prepared with the help of Anton Jevcak and Jean Nagant**

Outline

- Public investment in the EU budgetary surveillance framework
- Public investment in new MS and relation to private investment and EU transfers
- Conclusions

Public investment in the EU budgetary surveillance framework

S&G pact - no special treatment of public investment as regards the definition of the budget balance

- *but* - <u>in the context of the EDP</u> – when preparing a report if the actual or planned deficit goes above 3% of GDP according to Article 104(3) the Commission "…*shall also take into account whether the <u>government deficit exceeds government investment expenditure</u>*…".

Currently, <u>none of the new members</u> states has a <u>golden rule</u> at the central or general government level.

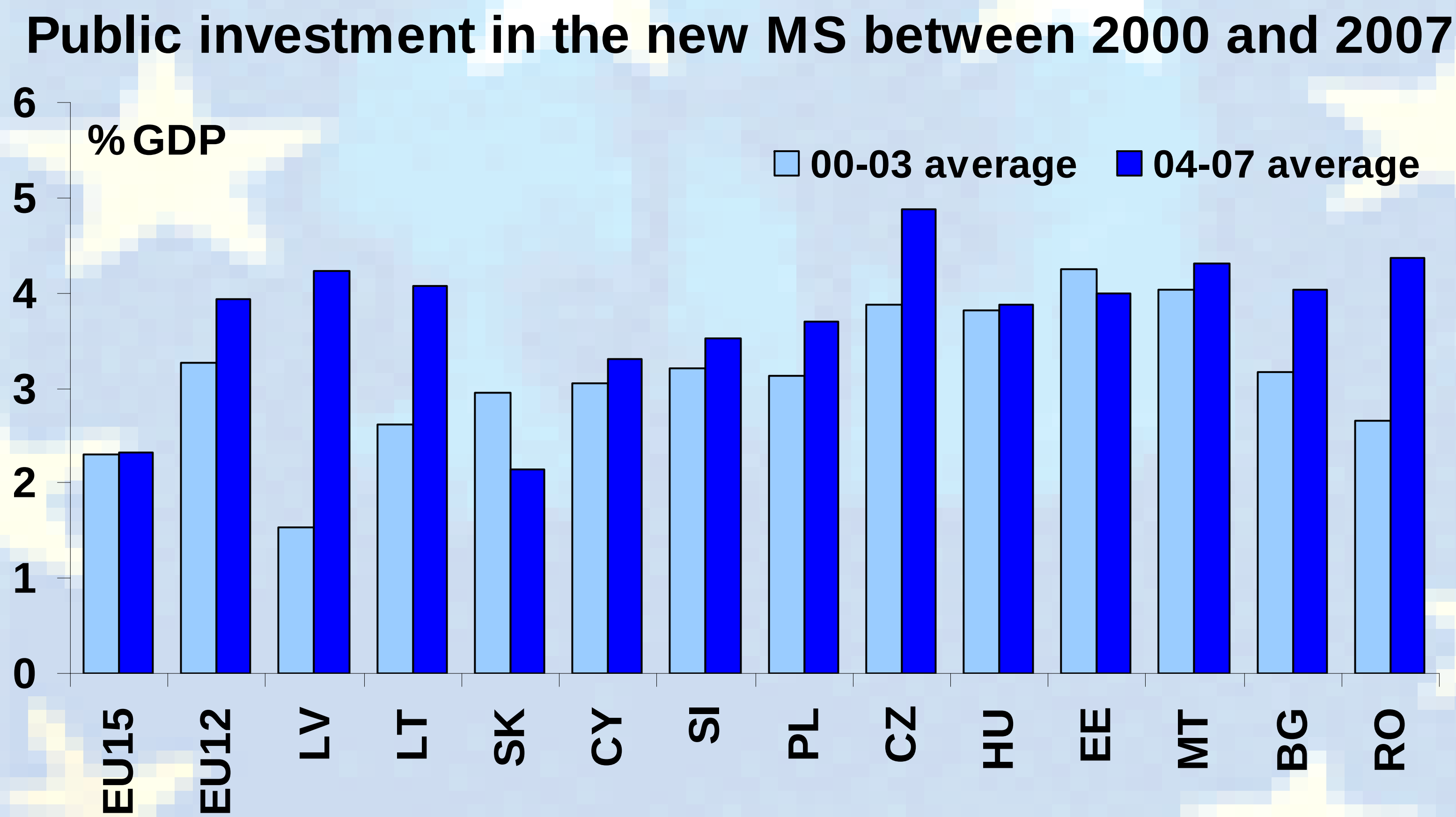
A rational for the golden rule

1. **Financing investment from current revenues may clash with consumption-smoothing objectives of governments**
2. **Productive public investment can pay for itself over the longer term**
3. **Institutional/political constraints – cutting public investment often politically easier than reducing current expenditure or rising taxes**
4. **Inter-generational equity – current generation should not carry the whole burden of public investment when enjoying only part of the long-term benefits**

Arguments against the golden rule

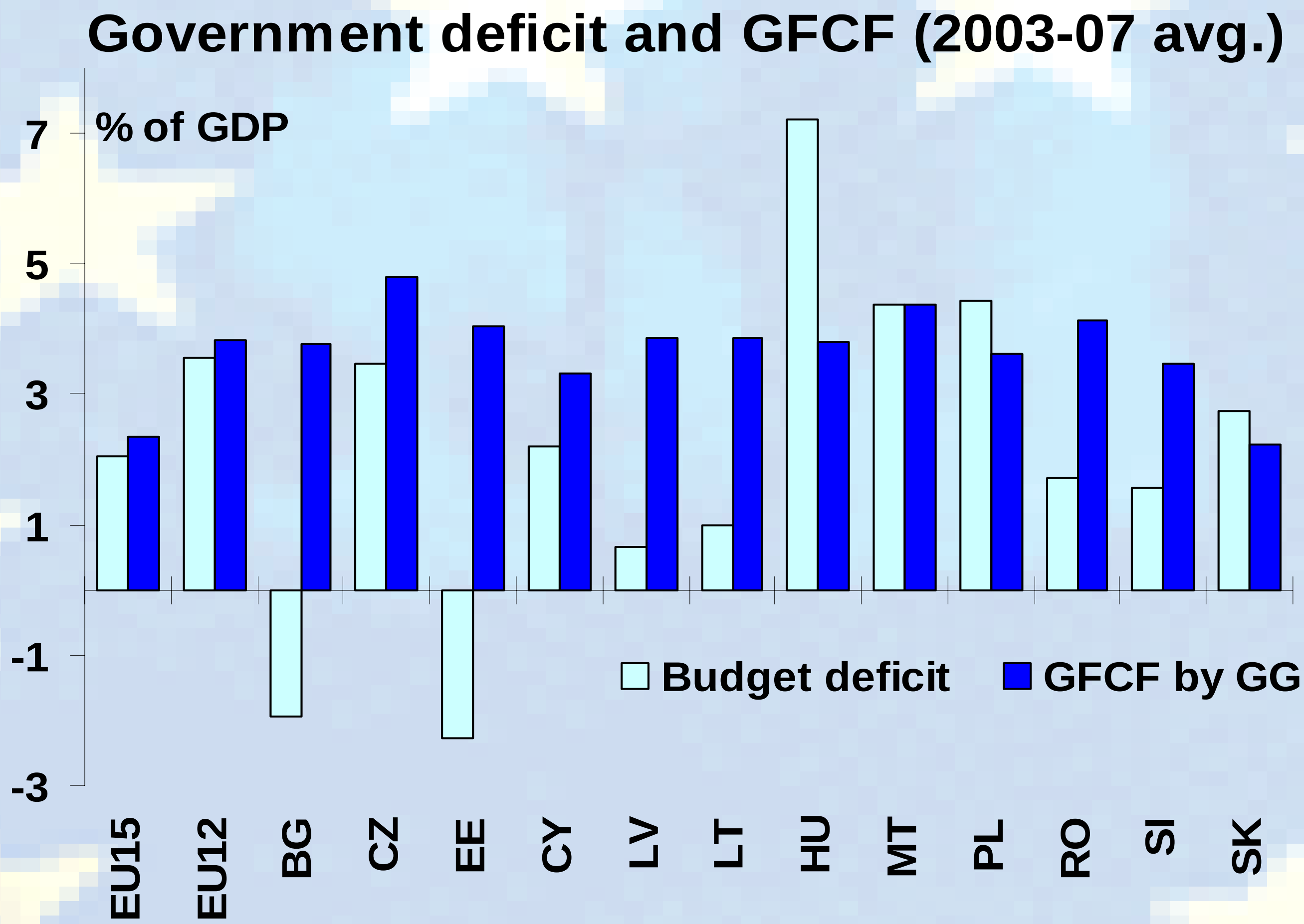
1. No strong empirical evidence that governments undertake too few public investments
2. In case of constrained financing/excess demand pressures – overall balances matter
3. Public investment may not be sustainable or may yield inadequate returns
4. Negative expenditure composition bias: financial constraints softened on investment in fixed assets, while investment in human capital or R&D constrained by deficit ceiling

Impact of EU accession on public investment



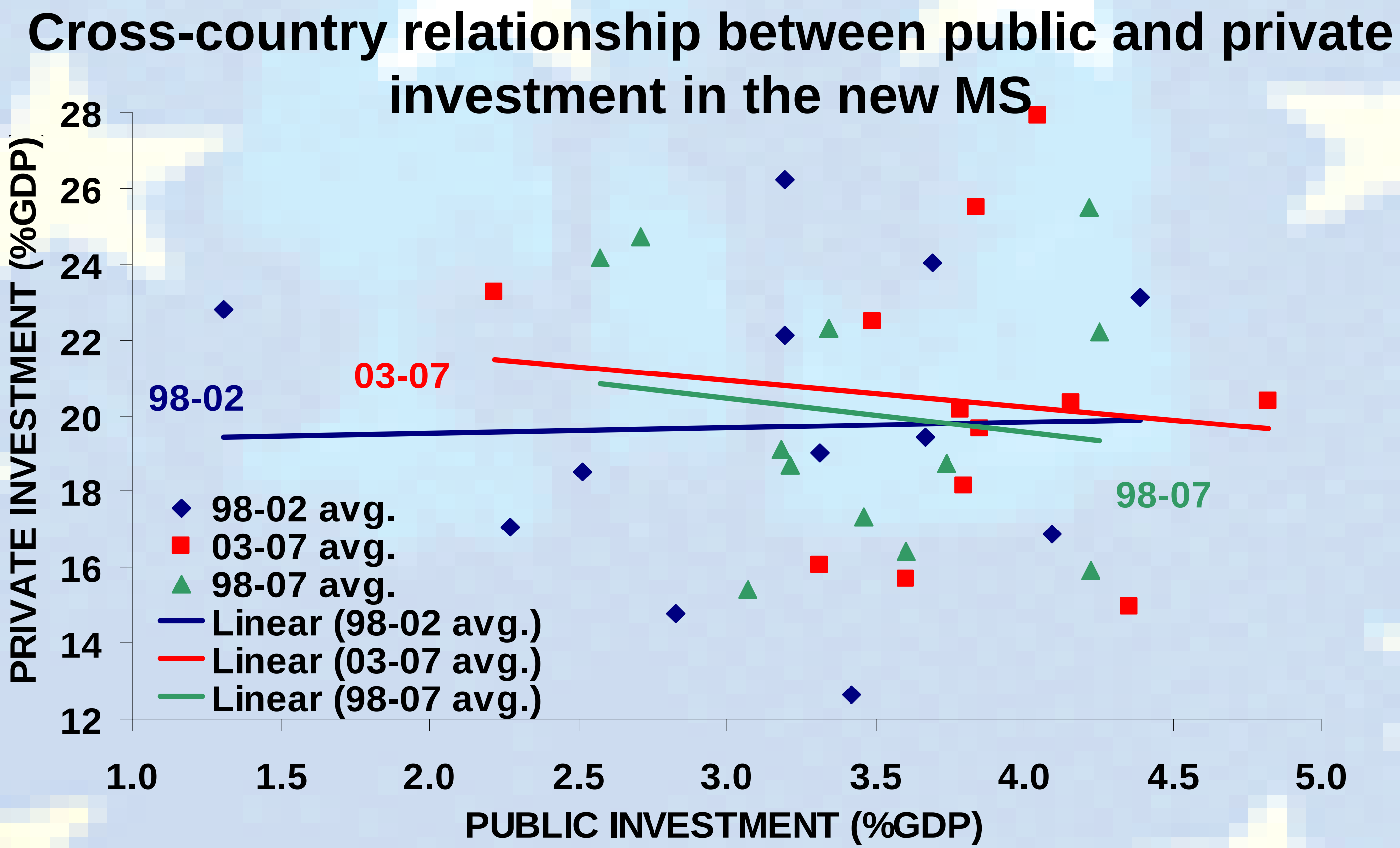
Average public investment in the new MS increased slightly as % of GDP but declined in SK and EE.

Public investment and borrowing in the EU



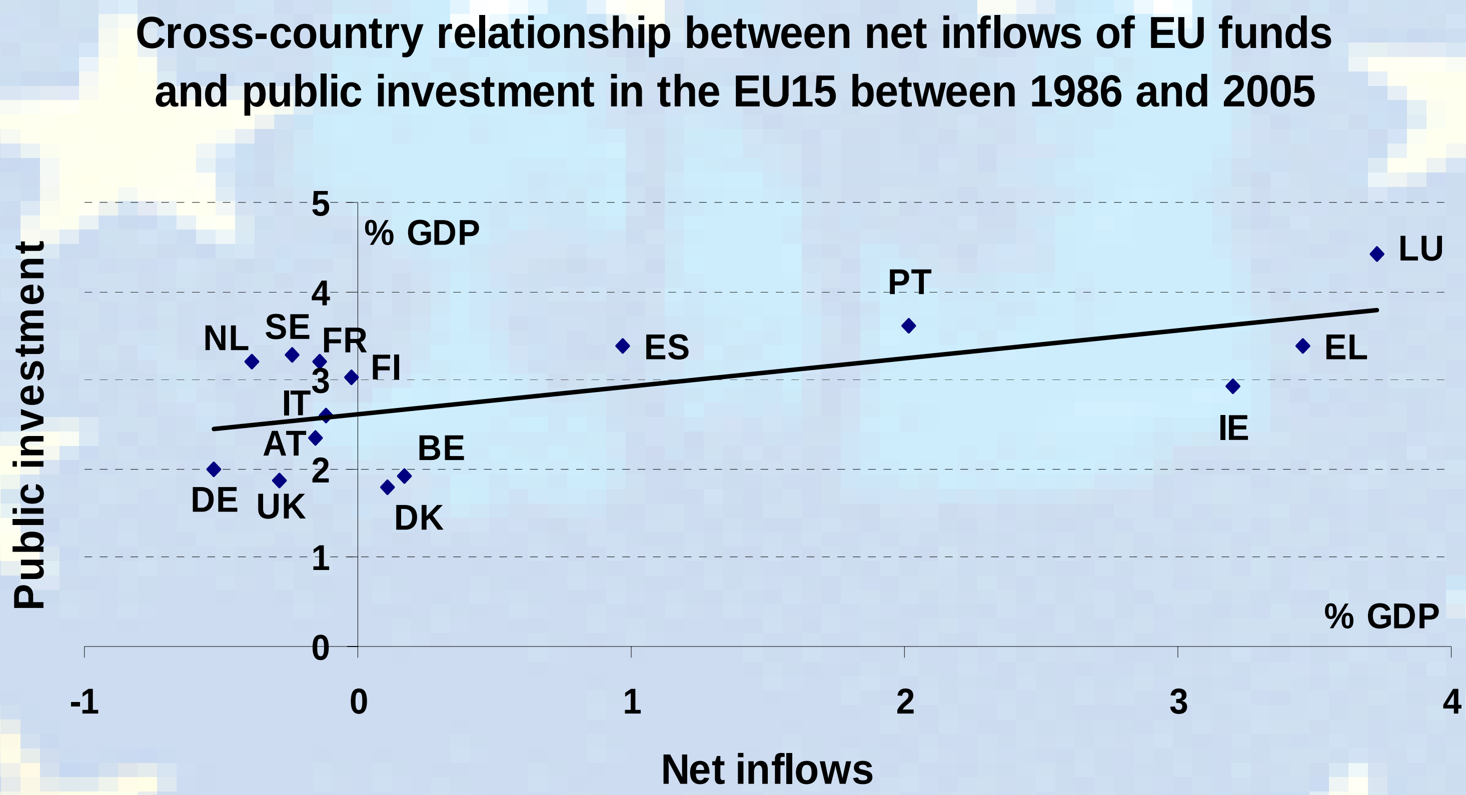
Public investment on average exceeds public deficits both in the EU15 and in the EU12, but not in the EDP countries (HU,MT,PL,SK) except for CZ,CY.

Complementarity or substitution between public and private investment?



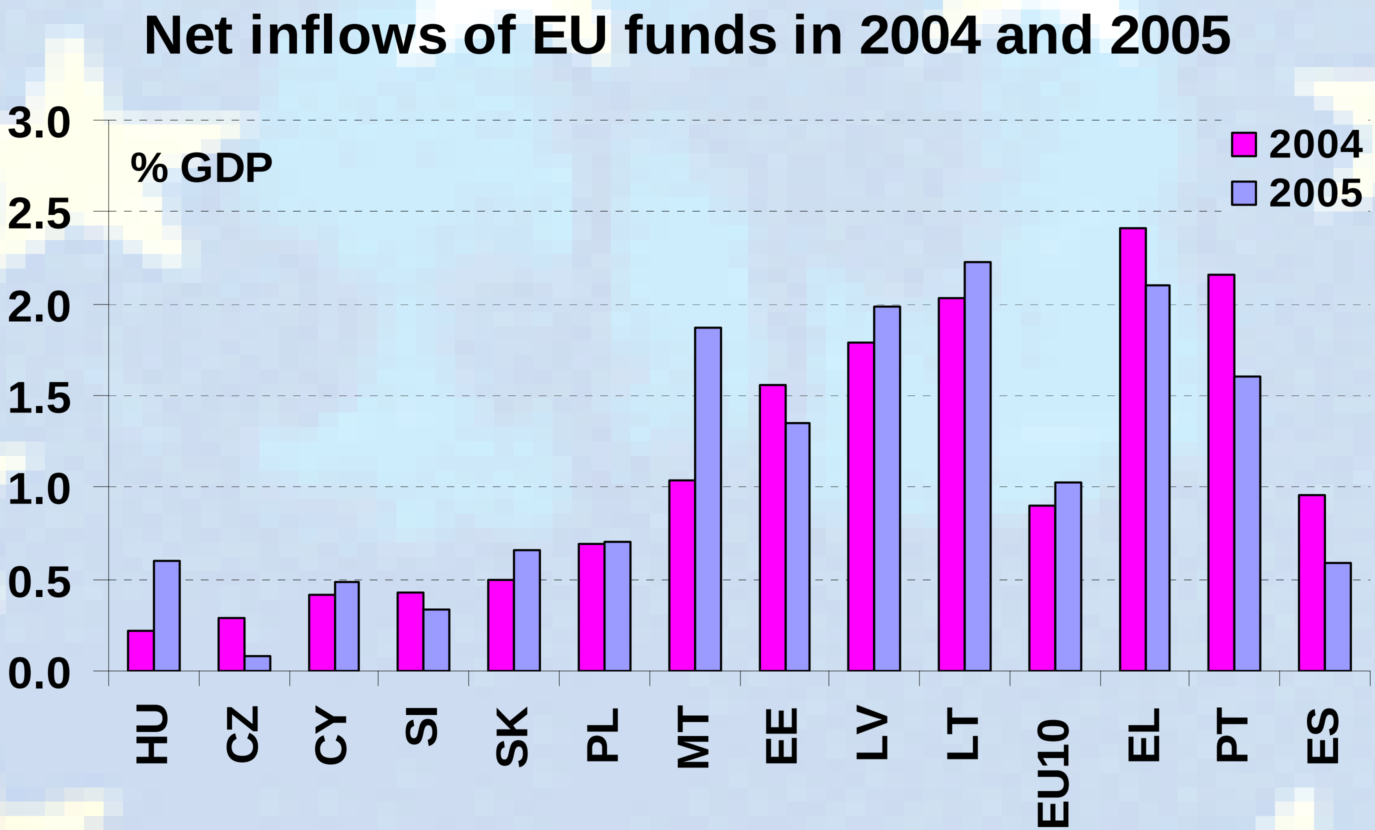
Positive relationship between public and private investment in the new MS seems to have faded out in the last 5 years

EU funds and public investment



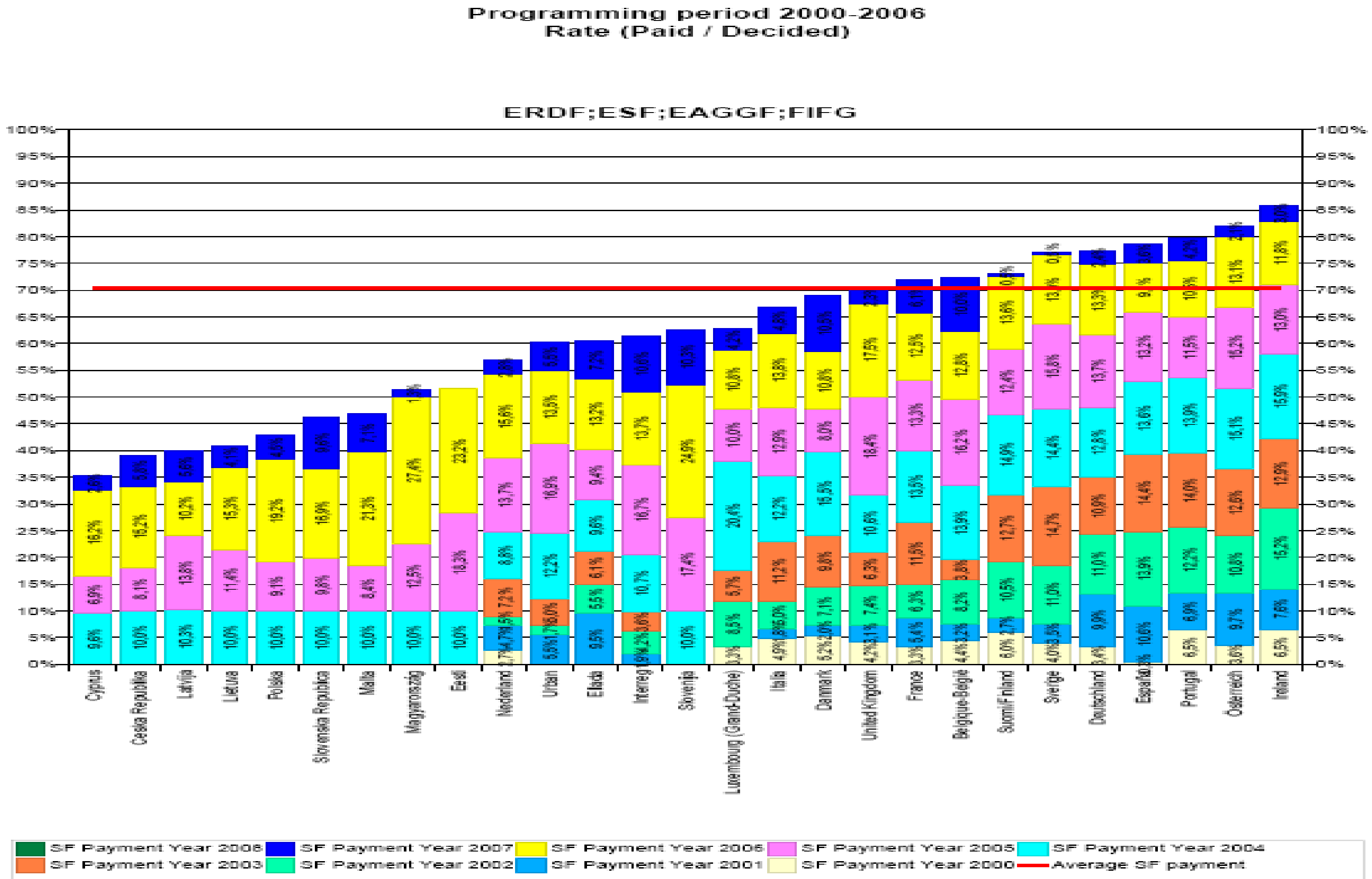
Higher net inflows of EU funds might enable governments to undertake more investments

Net inflows of EU funds into the new MS



Absorption of EU funds in the new MS in the first years of membership lower than in some old MS

Absorption of structural funds



Absorption has been relatively low so far,
but the time frame was also relatively short

Conclusions

- **The EU fiscal surveillance framework does not seem to hamper public investment;**
- **Positive relationship between public and private investment in the new MS seems to have faded out in the last 5 years**
- **EU funds can support public investment, but sufficient absorption capacities need to be established**