



# Convergence and the role of the Structural Funds: main lessons and policy challenges

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## Outline

- 1. The challenge of convergence**
- 2. The contribution of EU cohesion Policy**
- 3. Opportunities and potential risks**
- 4. Conditions for maximising the impact**

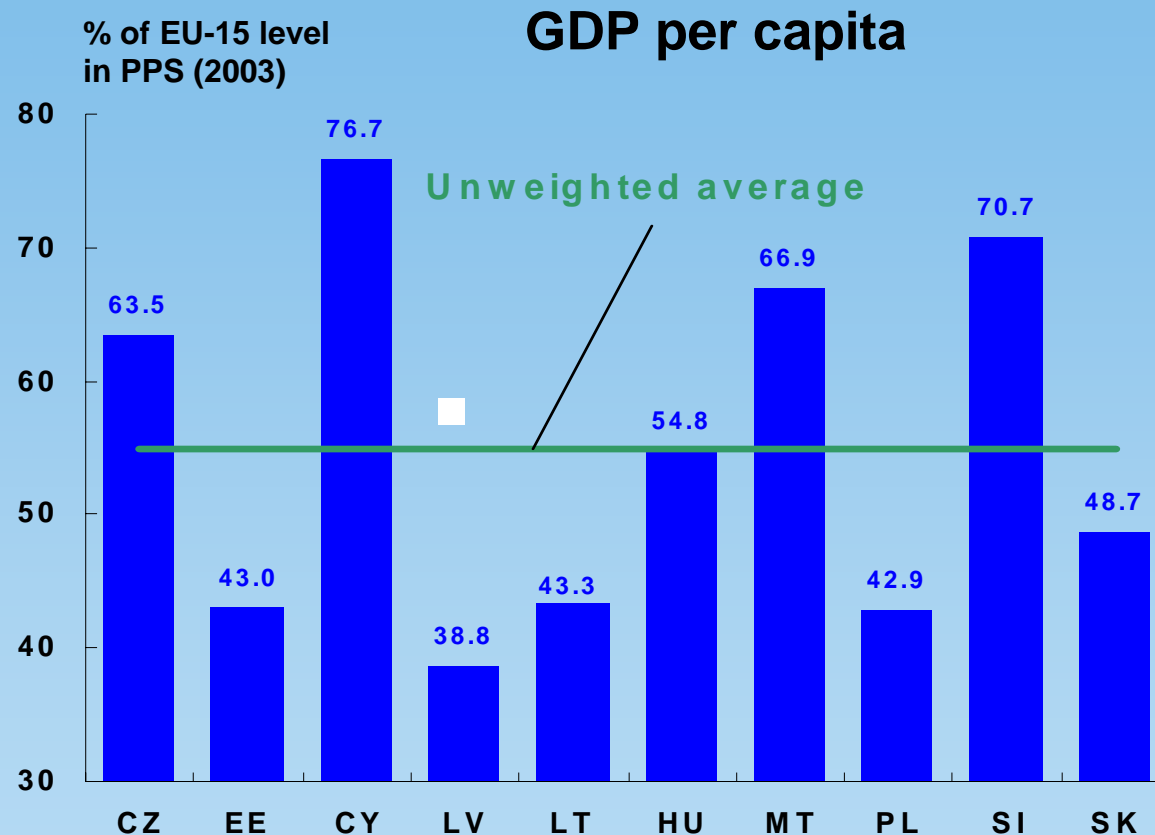


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# 1. The challenge of Convergence

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## The economies of the RAMS: basic facts

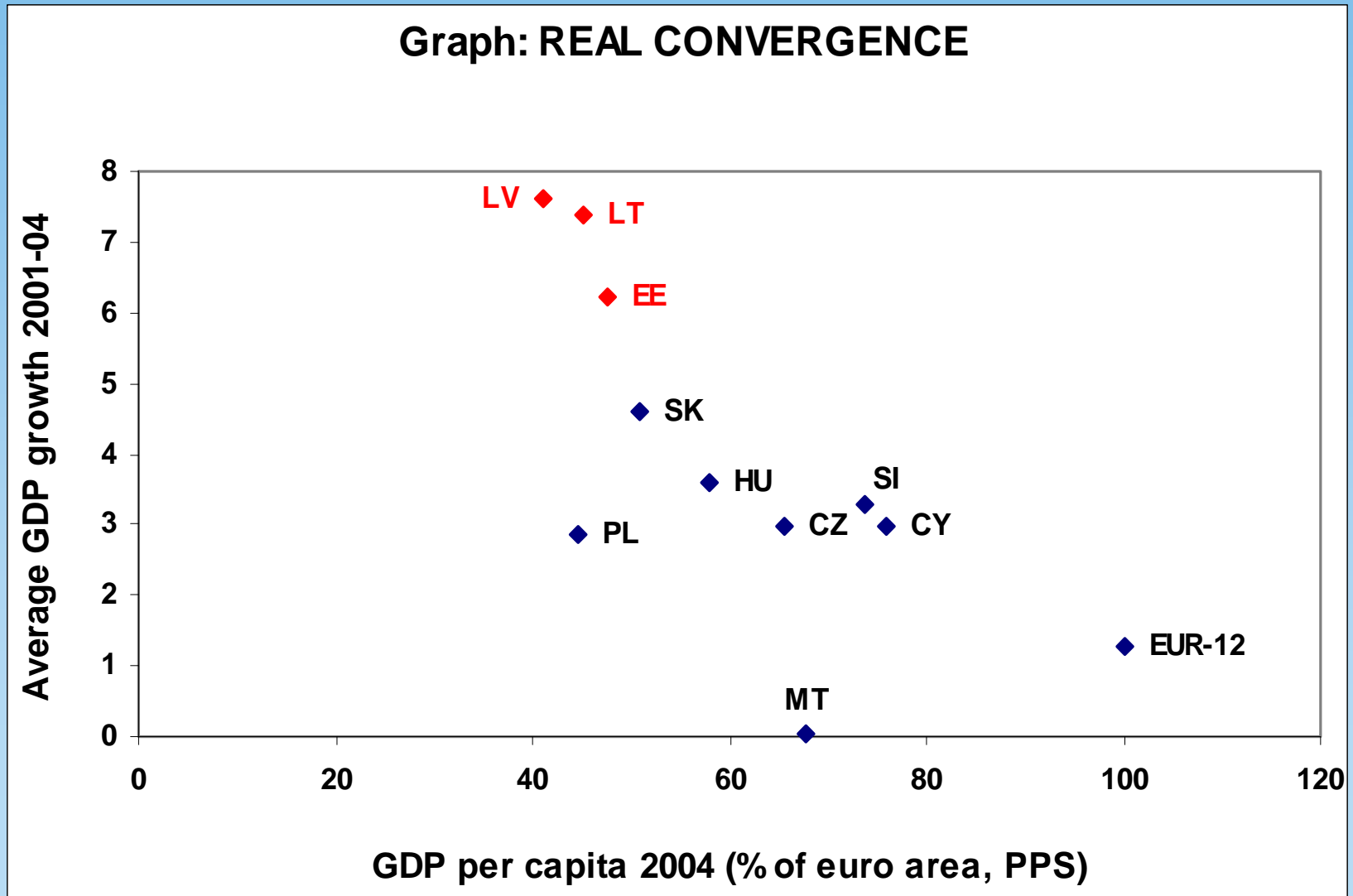


- A combined population of 75 million, i.e. about 20% of that of the EU-15
- An economic weight equivalent to 5% of EU-15 GDP
- A large gap in terms of per capita income levels



# Real Convergence

Graph: REAL CONVERGENCE



## Current state of nominal convergence

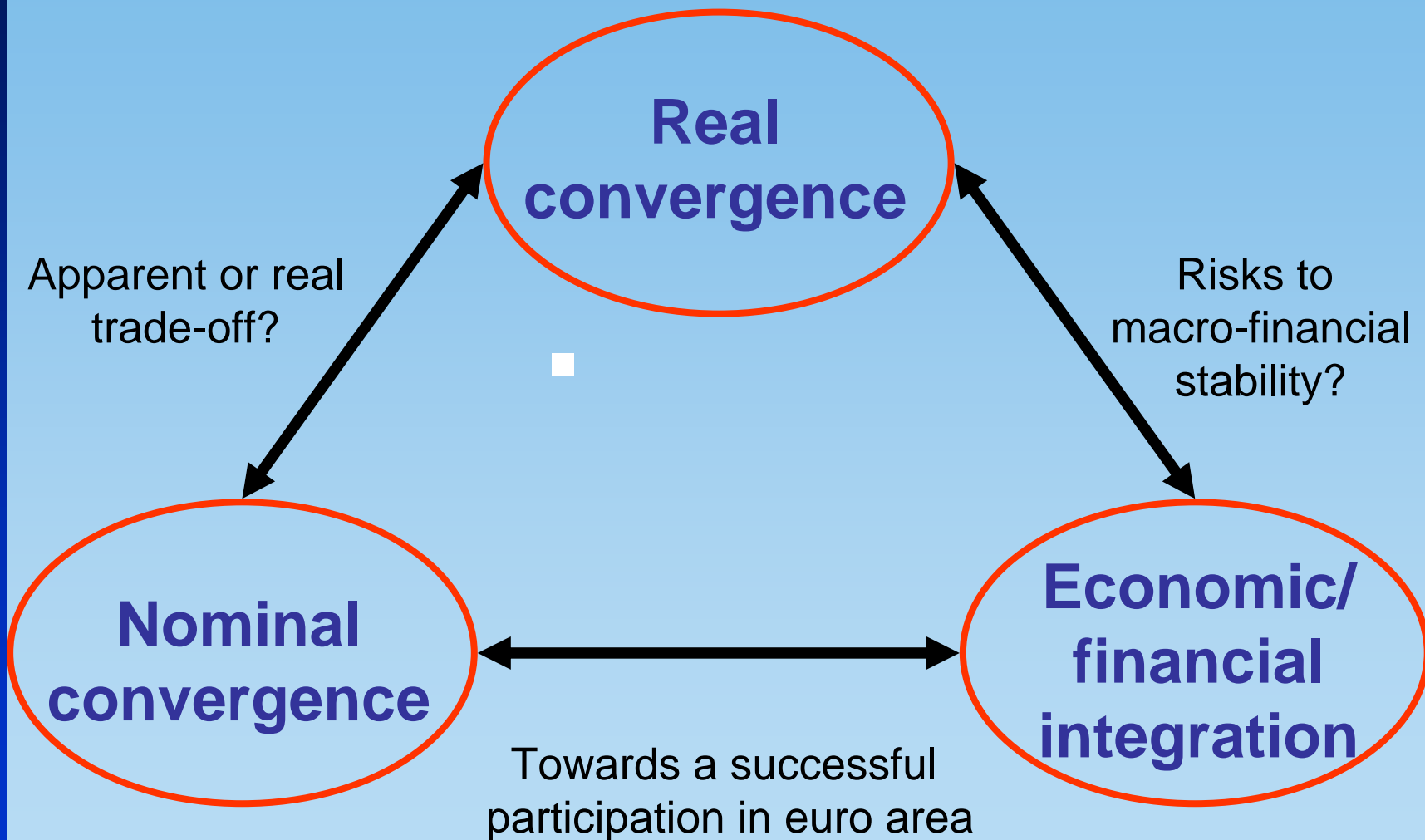
Country	Legal compatibility	Deficit 2004 (% of GDP)	Debt 2004 (% of GDP)	Inflation June 2005 (average, %)	LT rates June 2005 (average, %)	Exchange rate ERM II participation
Czech Rep.	no	3,0	37,4	2,1	4,2	no
Estonia	no	-1,8	4,9	4,1	4,2*	yes
Cyprus	no	4,2	71,9	2,5	6,2	yes
Latvia	no	0,5	14,4	7,0	4,4	yes
Lithuania	no	2,5	19,7	2,7	4,1	yes
Hungary	no	4,3	57,6	5,0	7,5	no
Malta	no	5,2	75,0	2,4	4,7	yes
Poland	no	4,8	43,6	3,8	6,2	no
Slovenia	no	1,9	29,4	3,0	4,2	yes
Slovakia	no	3,3	43,6	4,5	4,3	no
Euro area		2,7	71,3	2,0	3,8	
EU-25		2,6	63,8	2,2	4,1	

Source: Commission Services

\* May 2005



# The challenge of convergence





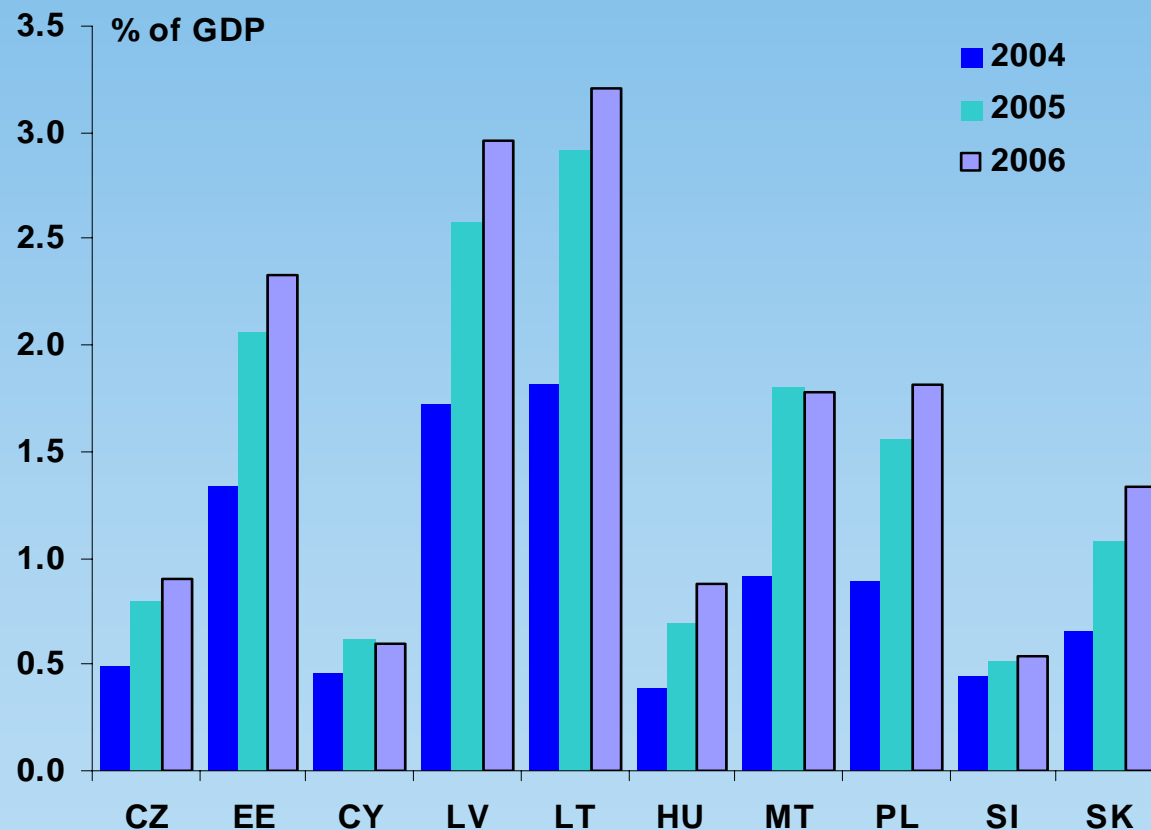
## 2. The Contribution of EU Cohesion Policy





## Real convergence and EU funds: considerable support in 2004-2006

### Estimated net payments from the EU budget

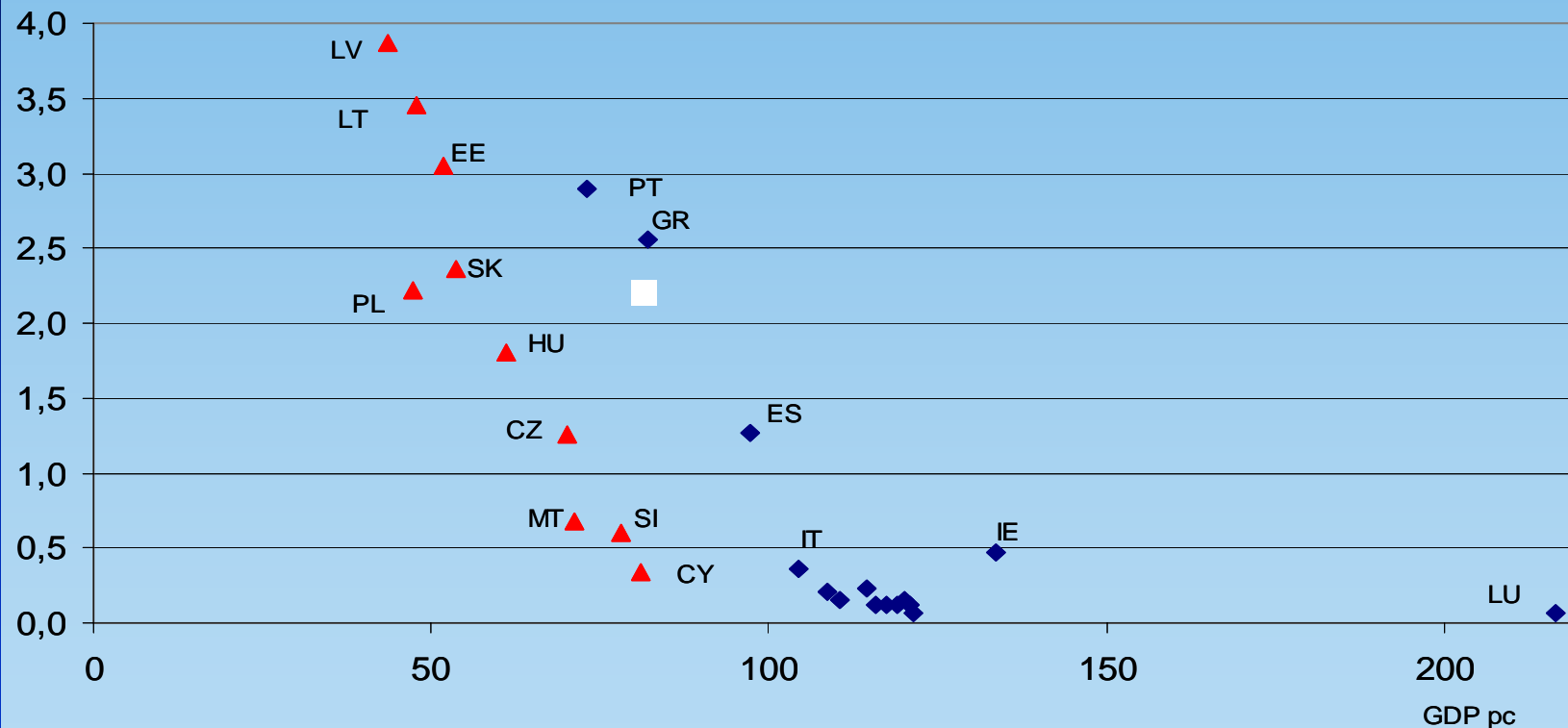


- Copenhagen package (EUR 25 bn)
- Pre-accession aid (EUR 4.6 bn)
- Contribution to EU budget (EUR 14.5 bn)



# SF + CF: Current Programmes

SF + CF as % of GDP

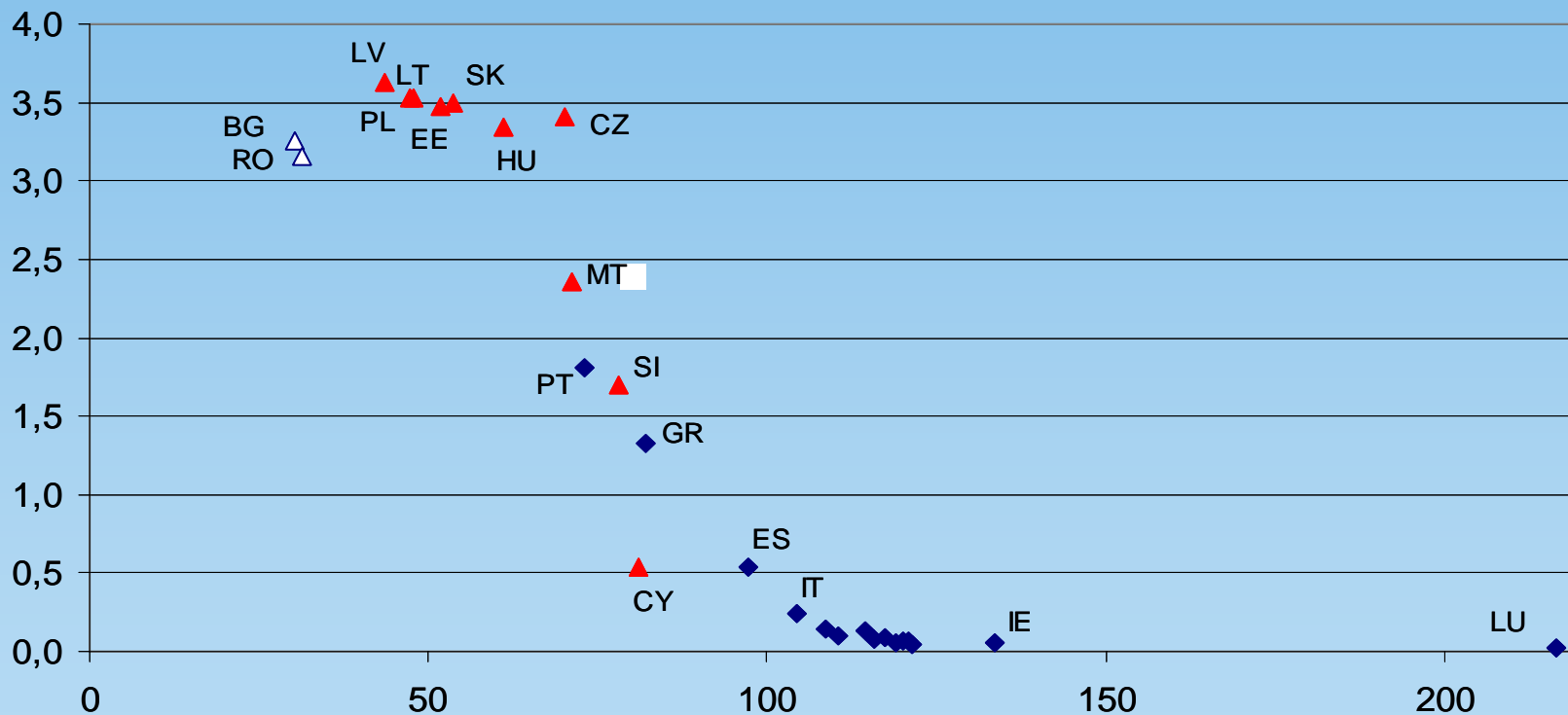


Annual average of Structural Funds and Cohesion Fund Commitments during the Programming Period 2000 – 2006 in 1999 prices as % of GDP 2003 in 1999 prices; GDP per capita in PPS, EU25 = 100 in 2004



# SF + CF: Programmes 2007 - 2013

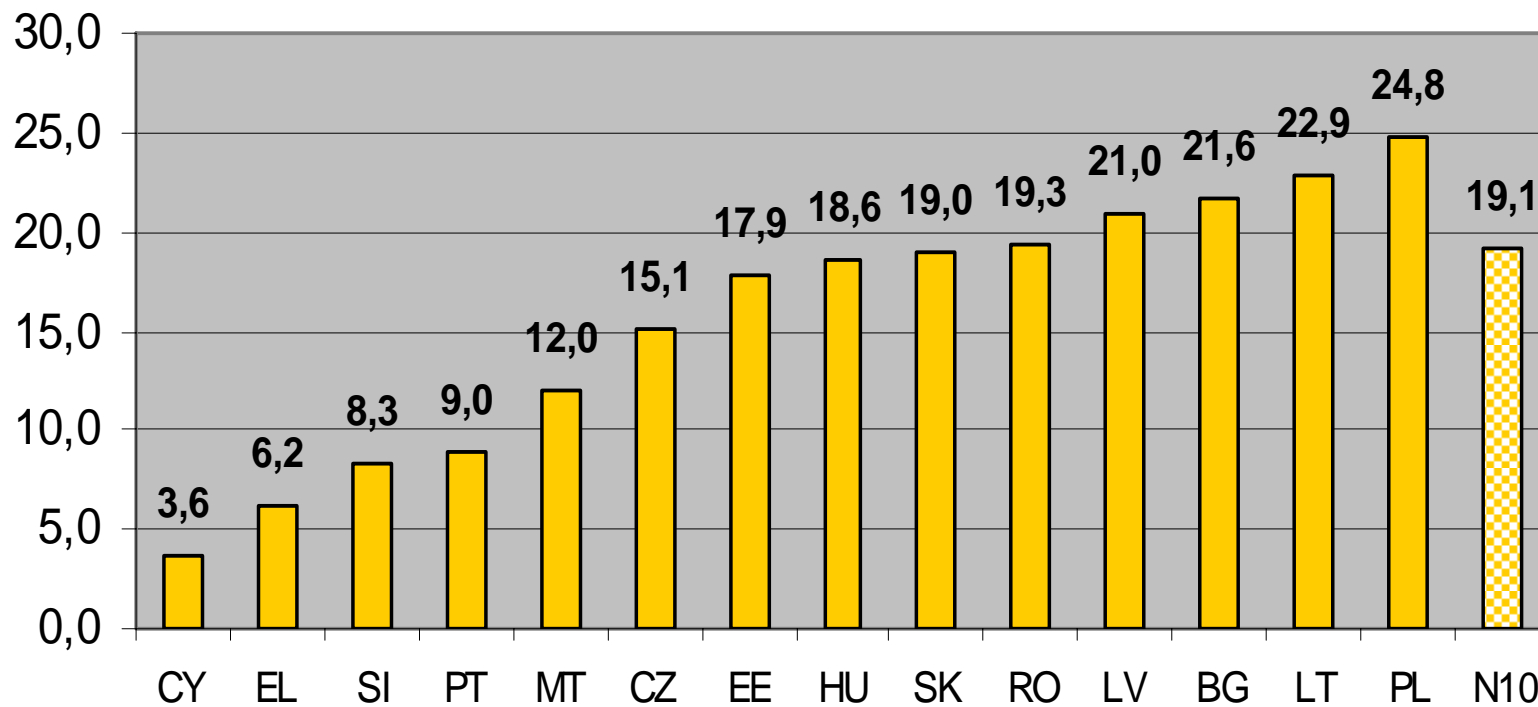
SF + CF as % of GDP



Annual average of Structural Funds and Cohesion Fund Commitments during the Programming Period 2007 – 2013 according to Luxembourg presidency proposal in 2004 prices as % of GDP 2004 in 2004 prices; GDP per capita in PPS, EU25 = 100 in 2004



**Average annual EU allocations 2007-13 in 2004 prices  
in % of GFCF 2004 in 2004 prices**





## Macro-economic models like Hermin or Quest II

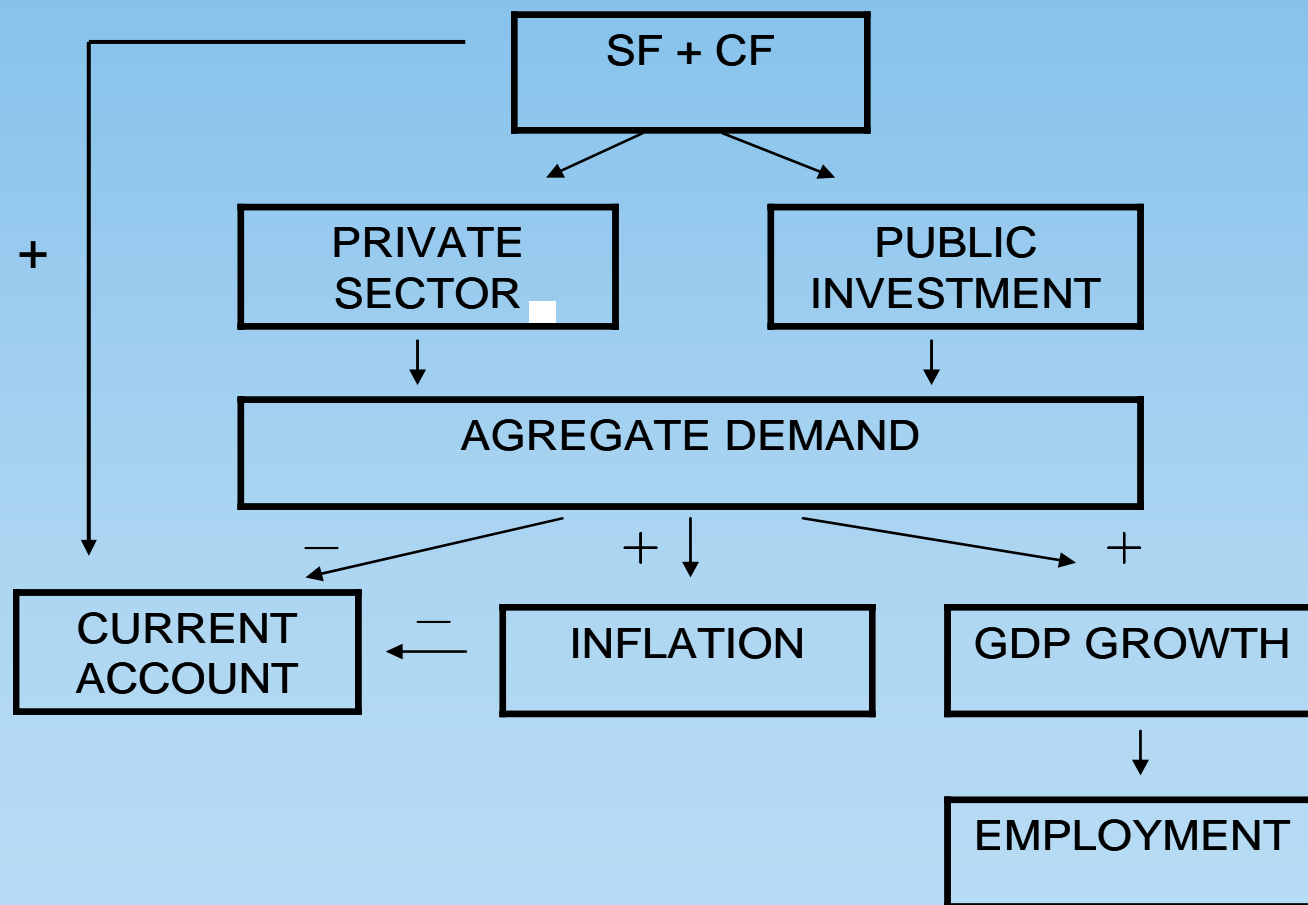
### Analysis of the counterfactual

- Showing the short term demand side as well as the long term supply side effects
- Different models lead to similar results for supply side effects



# Economic impact of SF

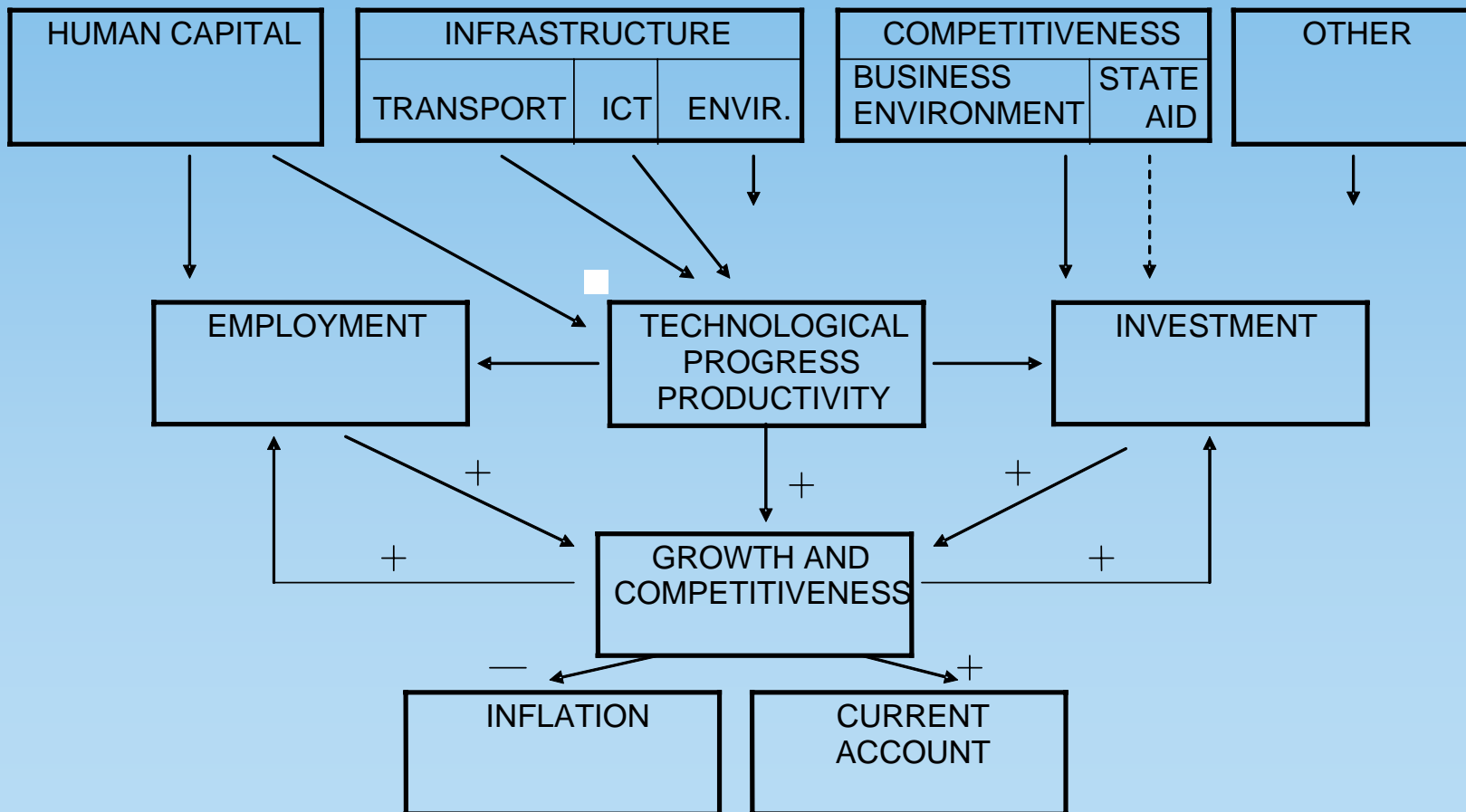
## Demand side effects





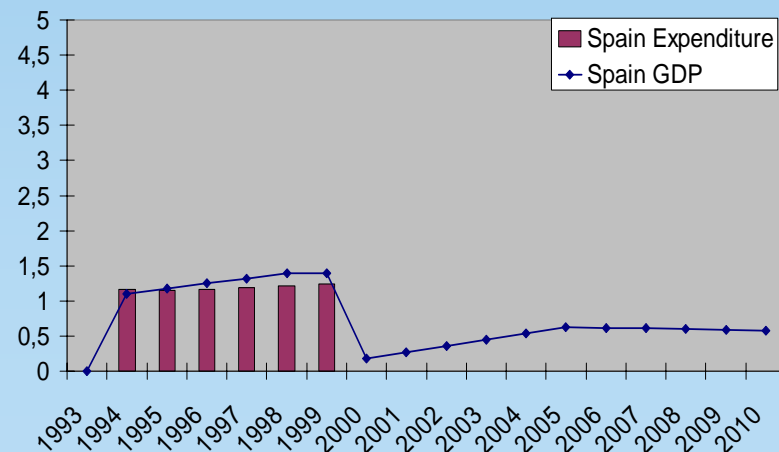
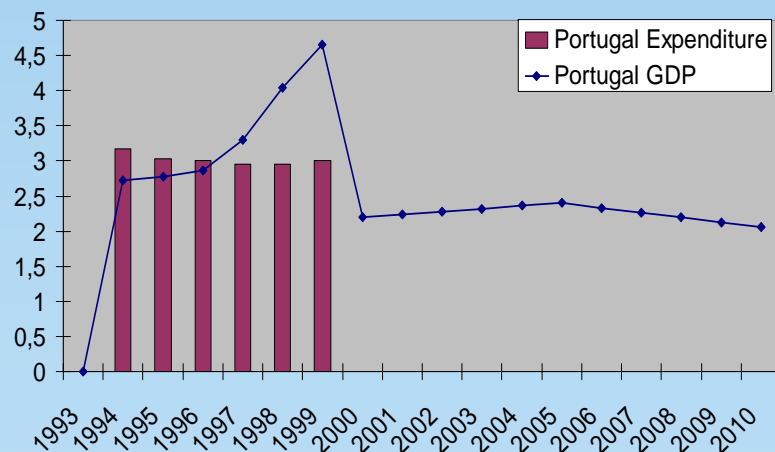
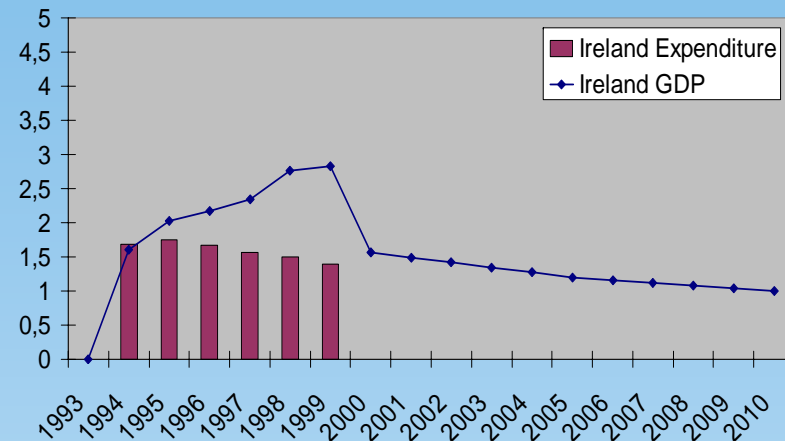
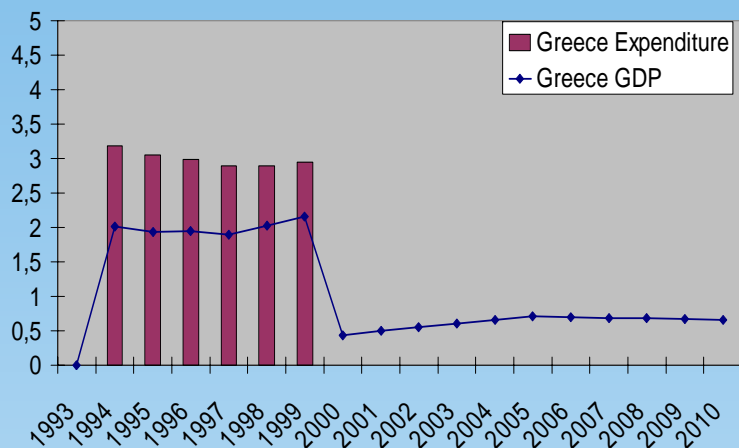
# Economic impact of SF

## Supply side effects





# Hermin Cohesion Countries Ex-post 1994-99







## Evidence of SF impact

### Econometric studies:

- Methodological and data weaknesses
- Results:
  - - *Positive effect on national growth*  
*e.g. Bosca et al. 1999, Garcia Solanes / Maria-Dolores 2001, Beugelsdijk / Eijffinger 2003. Exception: Ederveen / Goerter 2002*
    - *Partly positive effects on regional level*  
*e.g. Fayolle / Lecuyer 2000, Garcia Solanes / Maria-Dolores 2001, de la Funte 2003; no positive effects: Boldrin / Canova 2001 and Basile et al. 2002*



## Effects on Governance

i.e. improve the efficiency of public administration and public expenditure

- Bottom up approach/partnership arrangements
- Set up of integrated development strategy in a multi-annual framework
- Strengthening monitoring and evaluation
- Strict rules on financial management and cohesion
- Promote learning through exchange of goals practice and networking



## 3. Opportunities and potential risks





A key objective of cohesion policy for the period 2007-2013 is to maximise the long run growth potential of the least developed countries and regions in the EU ■

The issue is how to speed up real convergence while containing potential macroeconomic risks



## Nature of transfers

- Structural and cohesion funds are not *unconditional* financial grants (focus on investment not consumption); hence, they are expected to trigger supply-side effects
- Bulk of expenditure is on 'public goods' (i.e. physical infrastructure, education and training)

## Potential impacts

- Opportunities (or economic benefits) arise from supply-side effects over the medium and long term which are likely to increase productivity and output
- Main risks stem from demand-side effects in the short-medium term due to possible inflationary pressure and appreciation of nominal exchange rate

## (I) Boosting growth and jobs

A key aspect is productivity growth, which is determined by increases in the stock of human capital, R&D and improvements in physical infrastructure.

Other contributing factors include progressive opening up of the economies and growth in FDI

Job creation potential limited due to increases in total productivity



## (II) Trade balance: a mixed effect

- Substantial increase in imports of manufactured goods and business services linked to the development of physical and human capital
- This will improve supply side conditions *but* lead to an increased deficit by the end of the period
- Net progression of intra-EU trade, with positive effects on competitiveness and consumers





## (IV) Potential macroeconomic risks

- Overheating with inflationary pressures in certain sectors or in case of labour shortage, risk of persistent inflation unless offset by productivity gains (‘Balassa-Samuelson effect’)
- Higher interest rates which dampen domestic demand
- Currency appreciation → cost pressure for tradable sector and loss of competitiveness



## (V) Budgetary impact

- via restructuring of expenditure
  - EU funds only capital costs
  - MS must ensure maintenance over lifecycle of physical investment
- indirectly, additionality and co-financing requirement could lead to a rise in national structural expenditure

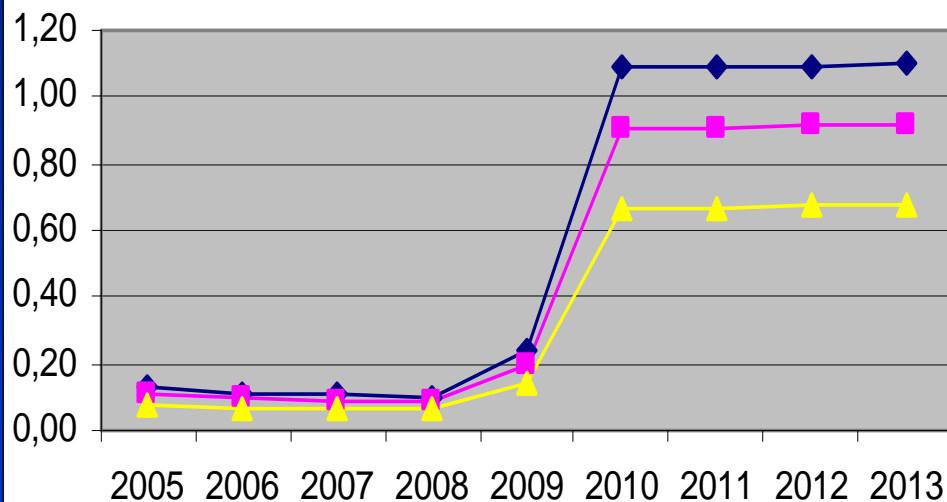
*Additionality requires that MS maintain as a general rule' at least the same level of national structural expenditure from one programming period to another. Only EU structural funds are additional.*



# Poland

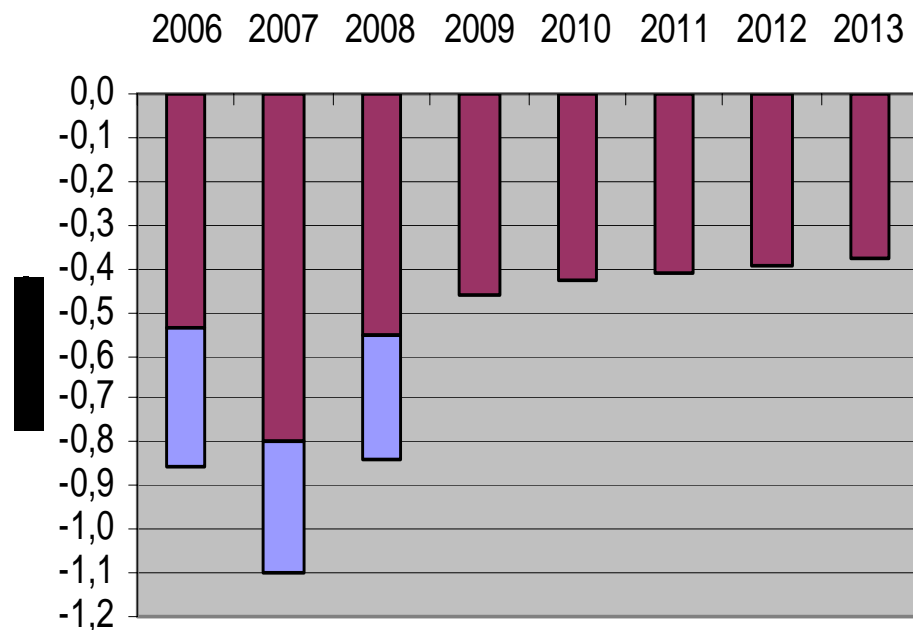
**National co-financing requirement in % of GDP**

Different EU financing ratios  
disbursements main scenario



- ◆ national co-fin ratio=0,3; payments: main scenario, deflator FP
- national co-fin ratio=0,25; payments: main scenario, deflator FP
- ▲ minimum nat. co-fin ratio=0,184; payments: main scenario, deflator FP

**Annual adjustment need for budgetary expenditure and additional risk in case of exchange rate appreciation**



- Budgetary risk due to xrate appreciation of 15%
- Primary expenditure



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## 4. Conditions for maximising the

- impact



## Conditions for making structural funds more effective

- Macroeconomic stability
  - low inflation and absence of significant external and fiscal imbalances
- Sound public finance
  - o efficient taxation and expenditure policies
  - o adequate provision of public goods, e.g. infrastructure, education, R&D
- Structural Reforms
- Adequate administrative capacity
- Better and more effective absorption of EU funds
- Positive spillovers on quality of investments



## Policy challenges

- Stronger spatial concentration to support catch up of poorer regions ('equity-efficiency trade off?')
- Appropriate investment mix to enhance productivity growth and employment
- Develop adequate institutional capacity to strengthen efficiency of public spending and accountability