



EUROPEAN CENTRAL BANK

The cyclical impact of EU Cohesion Policy in fast-growing economies

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16th Economic Forum, Krynica, 7 September 2006

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Introduction

- In the long run Cohesion Policy (CP) can help to increase the supply-side potential of supported economies.
- In the short- to medium-run, however, CP has considerable demand effects.
- What are the effects of the CP demand stimulus on the supported economies?
- Can the demand effects contribute to overheating?
- How can cyclical risks stemming from the CP be avoided?

Key features of CP in the CEE countries 2007-13

- Central and Eastern European EU Member States (EU8) will become the main beneficiaries of CP during the 2007-13 period
- EU8 countries can expect to receive CP transfers between 3.2 and 3.7% of GDP per annum.
- A significant share of it will be used for construction (up to 1.5 to 2% per annum?)

The macroeconomic environment

Key macroeconomic indicators in the main old and new recipients of CP support

	Cohesion 4* 1994-99	Cohesion 4 2000-06	Baltic countries and Slovakia 2006-07
GDP growth	4.8	3.6	7.3
Employment	58.0	63.6	64.2
Unemployment	11.8	8.4	9.2
HICP inflation	3.5	3.3	4.1
Wage growth	8.7	7.4	10.7

* *The Cohesion 4 group includes Ireland, Greece, Spain and Portugal*
Source: European Commission (Ameco).

Recent economic developments in EU8 countries

- The Baltic countries and Slovakia (CE 4) are expected to grow above 6% per annum in 2006 and 2007. Other EU8 countries between 4 and 5%.
- Unemployment in the Baltic countries is falling rapidly and stands around 7% now
- The CE 4 economies are now likely to operate above their current supply capacity.
- Wage pressure is particularly strong and accelerating in construction (in 2005 between 13 and 33% in CE 4).

How to avoid cyclical risks of CP support (I)?

- National Operational Programme design, programme management (timing) and project selection should take cyclical aspects into account.
- CP support should initially focus on removing existing bottlenecks (e. g. lack of skilled labour) instead of aggravating them (e. g. by focusing on construction-based activities).
- Use other economic policies to avoid overheating.

How to avoid cyclical risks of CP support (II)?

- The room for manoeuvre for monetary policy depends on the degree of exchange rate flexibility.
- Fiscal policy is key– and may need to be tightened in some countries.
- Structural reforms are important – e.g. increasing employment incentives and reducing residential construction incentives reduced - but they take time.

Thank you for your attention!