Box 2

EU COHESION POLICY IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

European regions with per capita income of less than 75% of the EU average can expect to receive considerable transfers from the EU in the context of the EU's cohesion policy.[1] Cohesion policy is financed by three funds, namely the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund. The main objective of EU cohesion policy is to reduce disparities between the levels of development of the various regions and Member States, in particular by improving the long-term growth and employment prospects of the supported regions, and thereby to support convergence towards higher levels of per capita income.[2] This is achieved mainly by co-financing investment in infrastructure and human capital and by providing financial support for other investment relevant for growth and convergence. This box reviews the planned cohesion-related transfers to central and eastern European countries, with a particular focus on the short-term challenges for macroeconomic stability.

During the "Financial Perspective 2007-13" the EU9 countries (i.e. Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia) will be the biggest beneficiaries of EU cohesion policy. This group of countries will receive around half of the total

1 For an overview of EU cohesion policy, see European Commission (2007), "Growing Regions, growing Europe: Fourth report on economic and social cohesion".

2 In addition to the "convergence objective", cohesion policy also covers, albeit to a lesser extent, the "regional competitiveness and employment objective", as well as the "European territorial cooperation objective".

EU support for cohesion in EU9 recipient countries for the period 2007-13

(allocations as a percentage of GDP)

	2007	2008	2009	2010	2011	2012	2013	Average 2007-13
Bulgaria	1.8	2.3	2.7	2.6	2.6	2.5	2.4	2.4
Czech Republic	2.7	2.5	2.5	2.4	2.4	2.3	2.2	2.4
Estonia	2.4	2.3	2.2	2.2	2.2	2.2	2.3	2.3
Latvia	2.5	2.3	2.2	2.2	2.3	2.3	2.3	2.3
Lithuania	2.8	2.6	2.5	2.5	2.5	2.5	2.4	2.5
Hungary	3.0	3.0	2.9	2.9	2.8	2.8	2.7	2.9
Poland	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.4
Romania	1.1	1.5	1.8	1.9	1.9	1.8	1.8	1.7
Slovakia	2.4	2.4	2.3	2.4	2.4	2.4	2.3	2.4
EU9 total	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.4

Sources: ECB calculations, European Commission (for cohesion policy-related expenditure allocations), European Commission AMECO database (for nominal GDP for the period 2007-09) and IMF World Economic Outlook database (for nominal GDP growth rates for the period 2010-12).
Note: Owing to a lack of projections, the nominal GDP growth rate for 2013 was set equal to the growth rate for 2012.

cohesion policy-related allocations for the 27 Member States. The commitments allocated to the EU9 for the period as a whole correspond, on average, to around 2½% of GDP per year (see table). Cohesion policy-related transfers are expected to decline slightly (as a percentage of GDP) over the period 2007-13 for all countries except Bulgaria and Romania. In the case of Bulgaria and Romania, commitments will peak in 2009 and 2010 respectively as a percentage of GDP, reflecting a gradual phasing-in of cohesion policy-related allocations following EU accession in 2007.

In the course of 2007 the individual EU countries submitted their "National Strategic Reference Frameworks" to the European Commission for approval, providing detailed information on the planned use of the cohesion policy-related transfers over the period 2007-13. Between 2000 and 2006, in line with objectives, these funds were largely used for enhancing productivity, in particular through infrastructure projects, investment in human capital, and research and development. Such projects and investment are again likely to account for a large share of cohesion policy-related expenditure in the EU9 over the period 2007-13. Given that infrastructure and human capital investment needs tend to be greater in the EU9 than in the benefiting countries and regions of the EU15 (i.e. countries that joined the EU before 2004), it is possible that the leverage effects of EU cohesion policy may be somewhat larger than in the past. However, cohesion policy-related funds may create challenges for fast-growing countries, as their short-term demand effects may exacerbate macroeconomic imbalances.[3]

In order to assess the demand effects of EU cohesion policy, one must distinguish between commitments made within the cohesion policy framework and actual payments, as their respective time profiles can differ substantially. Between 2004 and September 2007 the EU9 were, on average, able to administer only 56% of the committed ERDF funds. As regards the Cohesion Fund, the ratio of actual payments to commitments was as low as 22% for the same group of countries. As a result, it is unlikely that a smooth profile of actual payments will materialise during the period 2007-13. Owing to "teething problems" at the start of the planning period, actual payments tend to be accumulated at the end of the period. Since most of the payments go to infrastructure projects, significant demand effects are likely to arise, in particular in the construction sector, which is already experiencing bottlenecks in several EU9 countries.

3 See IMF (2007), "World Economic Outlook – October 2007", pp. 89-92, for an analysis of the macroeconomic imbalances that have emerged in Bulgaria, Estonia, Latvia, Lithuania and Romania over recent years.

In order to minimise the potential cyclical impact resulting from the demand effects of the EU transfers, national governments in EU9 countries and EU institutions would be well advised to consider the macroeconomic environment when deciding on the sequencing of cohesion policy measures over the programming period. For example, in countries with clear signs of overheating, postponing the implementation of EU-financed projects with considerable demand effects until the economy has cooled down may help to avoid further fuelling macroeconomic imbalances. The fact that in the recent past the EU9 have spent only around half of the funds allocated to them under the EU's cohesion policy would seem encouraging in this respect. However, the low implementation rate also reflects organisational issues related to administration and planning, which could undermine the cohesion policy in terms of promoting long-term economic growth and employment. In fact, better administration and planning is imperative in order to ensure the effective use of EU funds.

Ultimately, the guiding principle for economic policy-makers should be to ensure that the EU funds enhance long-term productivity, while avoiding, in times of overheating, an increased risk of unsustainable developments as a result of the additional demand stimulus from these funds.