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# A EUROPEAN FUND FOR ECONOMIC REVIVAL IN CRISIS COUNTRIES

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## Highlights

- Significant volumes of Structural and Cohesion Funds have been pre-allocated but remain undisbursed or uncommitted are significant. In Portugal, unused funds amount to 9.3 percent of GDP, in Greece close to 7 percent, and in central and eastern European countries about 15 percent. These funds should be part of a temporary European Fund for Economic Revival (EFER) for 2011-13, which would promote economic growth in crisis-hit countries and facilitate structural reforms.
- For countries under financial assistance in particular, the European Commission has a role to play in identifying the 'right' objectives for which the funds should be used. The Commission could decide to manage the funds directly with the support of an executive agency.
- Greater efforts should be made to exploit synergies between EU grants and European Investment Bank loans, allowing EIB loans to finance the total costs of a project or programme in small countries, and leveraging the whole EU budget to attract private investment.

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# A EUROPEAN FUND FOR ECONOMIC REVIVAL IN CRISIS COUNTRIES

BENEDICTA MARZINOTTO, FEBRUARY

## 1 INTRODUCTION

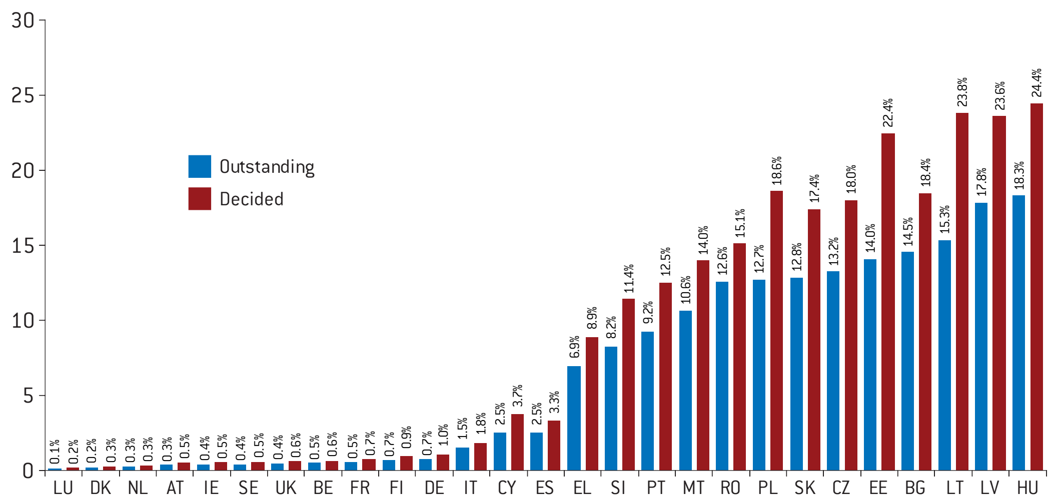
**The main recipients of European Union Structural and Cohesion Funds** still have to absorb considerable proportions of the amounts earmarked to them for the 2011-13 period. In Greece, the amount is in the order of 7 percent of GDP, in Portugal about 9.3 percent of GDP, and in central and eastern European countries that joined the EU in 2004 and 2007, the average is close to 15 percent of GDP (see Figure 1)[1].

In the current debate on the European crisis, insufficient attention is being paid to the possible use of these immense resources for crisis management and resolution. The money could serve three purposes: i) compensate for the recessionary impact of fiscal consolidation, whether countries have received financial assistance and are thus under strict conditionality (ie Greece, Hungary, Latvia and Romania) or are consolidating to avoid having to recourse to financial assistance (eg Portugal and Spain); ii) preserve essential public investment in infrastructure, human capital and research, thereby promoting potential output growth; and facilitate structural reform in countries that are under strict conditionality.

Two main points can be made about the role of EU funds in bad times. First, the size of Structural and Cohesion Funds has been so far underestimated and the numbers are far from trivial[2]. Second, the reason why their full potential has remained unfulfilled for so long relates to issues of governance, as will be explained in section 4. The empirical support for positive effects from EU transfers is weak, not necessarily because they are too small to make a difference but because they have been poorly and badly absorbed by EU member states[3]. We suggest that the governance of Structural and Cohesion Funds needs to be reformed by revising their objectives and delivery, and even contemplating, for certain types of projects, that in times of crisis the funds are directly administered by the European Commission with the support of an executive agency[4].

Section 2 describes the size of Structural and Cohesion Funds under the current 2007-13 multiannual financial framework (MFF). Section 3 looks at their absorption compared with the previous programming period of 2000-06. Section 4 looks at the general issue of governance, addressing the questions of absorption, objectives and delivery. Section 5 briefly considers the role of

**Figure 1: Total and oustanding commitments from MFF 2007-13 (as of end 2010), % of GDP**




Source: Bruegel based on European Commission data.

1. We measure total outstanding commitments as the sum of the outstanding amount for each year as a proportion of that year's GDP. For 2011 and 2012, we use the European Commission's GDP forecast, and for 2013 our own estimate.

2. On the other hand, the EU budget as a whole has played an important but mostly unnoticed role in the crisis. The European Financial Stabilisation Mechanism (EFSM) is an extension to the euro area of existing medium-term financial assistance (MTFA) in favour of non euro-area member states, and sees the European Commission borrowing up to €60 billion on capital markets under an implicit EU budget guarantee.

3. See section 4 for discussion of the economic impact of Structural and Cohesion Funds.

4. See footnote 17.

*'In the current debate on the European crisis, insufficient attention is being paid to the possible use of the immense resources of the Structural and Cohesion Funds for crisis management and resolution.'*

loans granted by the European Investment Bank (EIB) compared with EU grants. Section 6 offers some concluding remarks.

## 2 THE SIZE OF EU FUNDS

The current MFF (2007-13) allocates to member states a total of about €348 billion under heading 1B of the EU budget, equal to 2.8 percent of EU GDP or 0.4 percent per year on average. The standard argument is that, due to their size, EU funds are not as powerful an instrument for resource allocation as the national budget of a federal state. This is the wrong way to look at Structural and Cohesion Funds. First, the EU is not a proper federal system, hence the comparison is unwarranted. Second, EU support for cohesion represents a significant amount when compared, for example, with the size of the rescue packages to Greece (€110 billion) and to Ireland (€85 billion). Third, Marshall Plan aid from 1948-51 was only about 2 percent of the GDP of all recipient countries, but made a substantial contribution to western European growth by altering the political economy environment[5]. If the objectives of Structural and Cohesion Funds are clarified and their delivery is reformed, they can make an important contribution to growth and convergence that goes well beyond their face value.

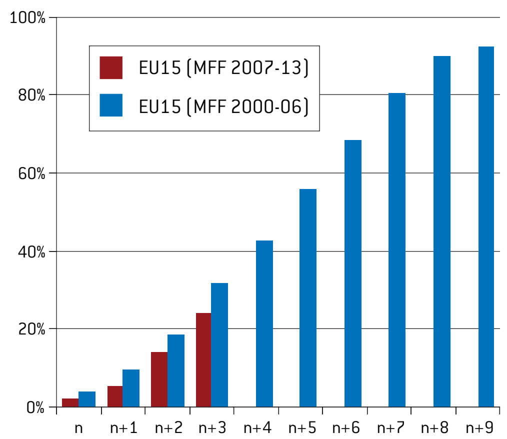
All the funds are pre-allocated country by country on the basis of the recipient's level of economic development, population size and surface area, and subject to agreement on so-called Operational Programmes (OPs). Table 1 on the next page shows national commitment appropriations between 2007 and 2013, as agreed at the beginning of the programming period. Table 2 (next page) shows commitment appropriations as a proportion of the recipient country's GDP per year. The 'total' column is the simple sum of each year's allocations over the entire programming period. Put this way, the figures show the strong distributional component of Structural and Cohesion Funds, with in fact the central and eastern European (CEE) member states, Greece and Portugal receiving greater amounts of funding relative to the size of their national economy than the other EU member states.

## 3 THE POOR-ABSORPTION PROBLEM

EU funds are only partially and in any case too slowly absorbed[6]. A country's absorption capacity is captured by the evolution of the difference between commitment appropriations and executed payments (ie the so-called *reste à liquider* or RAL).

Out of the total 2007-13 allocation there are for the EU27 about €270 billion still outstanding and €134 billion uncommitted (ie coinciding with the sum of the 2011, 2012 and 2013 financial envelopes)[7]. Absorption has been progressing more slowly than the previous programming period. Figure 2 shows figures for the current and the previous MFF only for the EU15 countries to allow comparability across the two programmes. In the current period, there is a delay of about one year in the absorption of EU funds, compared to 2000-06. Two factors may have contributed to the markedly slower disbursement this time: i) the relaxation of the n+2 rule in 2007 which has probably relieved some countries of the pressure to accelerate the planning and implementation of EU-funded projects[8]; and ii) the difficulty in securing

**Figure 2: The pace of absorption in the EU15 across programmes**




Source: Bruegel based on European Commission data.

6. One example is the Financial Times' survey on Structural Funds, 'Europe's hidden billions – tracking EU Structural Funds', December 2010.

7. EU member states have committed all the resources they had available until the end of 2010 and will proceed by committing again the full amount in the three remaining years. Payments, on the other hand, are executed more gradually year after year due to the multiannual character of most projects and are expected to reach a cumulative execution rate of 95 percent by 2015.

8. Under the n+2 rule, countries lose the funds that are still unused two years after they have been allocated (ie decommitment).

**Table 1: Pre-allocated Structural and Cohesion Funds under the Multiannual Financial Framework 2007-13 (€ millions)**

| € millions | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Total |
|---|---|---|---|---|---|---|---|---|
| Belgium | 364.8 | 355.1 | 338.9 | 324 | 308.4 | 292 | 274.7 | 2257.9 |
| *Bulgaria* | 514.2 | 737.4 | 991.8 | 1044.1 | 1116.2 | 1188.6 | 1260.6 | 6852.9 |
| *Czech Rep.* | 3062.7 | 3736.7 | 3640.9 | 3809.5 | 4057.2 | 4225.3 | 4396.4 | 26928.7 |
| Denmark | 82.2 | 83.9 | 85.6 | 87.5 | 89.4 | 91.3 | 93.2 | 613 |
| Germany | 3664.8 | 3696.9 | 3729.7 | 3763.1 | 3796.3 | 3828.5 | 3860.5 | 26339.8 |
| *Estonia* | 375.8 | 410 | 446.4 | 486.2 | 530.4 | 578.2 | 628.8 | 3455.8 |
| Ireland | 211.6 | 180.7 | 148.5 | 115 | 80.1 | 81.8 | 83.5 | 901.4 |
| *Greece* | 3081.8 | 3030.4 | 2965.7 | 2900.5 | 2831.9 | 2814.5 | 2795 | 20419.8 |
| Spain | 6286.2 | 5754.6 | 5190.3 | 4713.8 | 4449.8 | 4426.4 | 4395.8 | 35217 |
| France | 1903.7 | 1979.6 | 2002 | 2043.8 | 2086.9 | 2129.8 | 2173.1 | 14318.9 |
| Italy | 3926.5 | 4107.2 | 4066.8 | 4098.6 | 4132.6 | 4204.6 | 4275.4 | 28811.8 |
| *Cyprus* | 167.2 | 139.4 | 109.8 | 79.1 | 47.2 | 48.1 | 49.1 | 640 |
| *Latvia* | 506.3 | 554.2 | 603.9 | 655.7 | 710.4 | 766.4 | 823.6 | 4620.4 |
| *Lithuania* | 765.4 | 833.4 | 902.5 | 975.2 | 1053.3 | 1136.2 | 1219 | 6885 |
| Luxembourg | 8.8 | 8.9 | 9.1 | 9.3 | 9.5 | 9.7 | 9.9 | 65.3 |
| *Hungary* | 3034.1 | 3229.3 | 3437.7 | 3625.5 | 3785.2 | 3991.5 | 4204.1 | 25307.4 |
| *Malta* | 112.9 | 118.7 | 119.8 | 122.6 | 125.1 | 127.2 | 129.1 | 855.4 |
| Netherlands | 254.1 | 262.4 | 266.4 | 272.2 | 278.1 | 283.9 | 289.9 | 1907 |
| Austria | 201.8 | 204 | 206.3 | 208.7 | 211.1 | 213.5 | 215.8 | 1461.1 |
| *Poland* | 8115.6 | 8664.5 | 9213.7 | 9441.4 | 10241.1 | 10822.8 | 11417.5 | 67916.6 |
| *Portugal* | 2971.5 | 3005 | 3038.7 | 3072.6 | 3106.7 | 3140.8 | 3175 | 21510.6 |
| *Romania* | 1328.9 | 1915.6 | 2576.3 | 3092 | 3333.6 | 3583.4 | 3837.9 | 19667.6 |
| *Slovenia* | 554.6 | 569.3 | 584.5 | 600 | 615.9 | 632.2 | 648.9 | 4205.3 |
| *Slovakia* | 1299.1 | 1407.2 | 1526.1 | 1662.3 | 1831.4 | 1953.1 | 2046.5 | 11725.6 |
| Finland | 259.8 | 257.6 | 251.9 | 245.9 | 241.1 | 234.4 | 225.7 | 1716.2 |
| Sweden | 253.2 | 259.1 | 264.4 | 269.9 | 276 | 281.6 | 287.1 | 1891.3 |
| UK | 1593.6 | 1598.7 | 1533.5 | 1489.3 | 1442.8 | 1465.9 | 1489.3 | 10613.2 |
| **Total** | **45061** | **47266.8** | **48427.2** | **49393.5** | **50985.5** | **52759.6** | **54523.6** | **348417.2** |

**Table 2: Pre-allocated Structural and Cohesion Funds under the Multiannual Financial Framework 2007-13 (% GDP)**

| % GDP | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Total |
|---|---|---|---|---|---|---|---|---|
| Belgium | 0.11 | 0.1 | 0.1 | 0.09 | 0.08 | 0.08 | 0.07 | 0.64 |
| *Bulgaria* | 1.67 | 2.08 | 2.83 | 2.91 | 2.96 | 2.96 | 3.02 | 18.43 |
| *Czech Rep.* | 2.41 | 2.53 | 2.65 | 2.6 | 2.6 | 2.58 | 2.6 | 17.98 |
| Denmark | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.26 |
| Germany | 0.15 | 0.15 | 0.16 | 0.15 | 0.15 | 0.14 | 0.14 | 1.04 |
| *Estonia* | 2.37 | 2.55 | 3.22 | 3.43 | 3.49 | 3.6 | 3.76 | 22.41 |
| Ireland | 0.11 | 0.1 | 0.09 | 0.07 | 0.05 | 0.05 | 0.05 | 0.53 |
| *Greece* | 1.37 | 1.29 | 1.27 | 1.26 | 1.25 | 1.22 | 1.19 | 8.86 |
| Spain | 0.6 | 0.53 | 0.49 | 0.45 | 0.42 | 0.4 | 0.39 | 3.27 |
| France | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.72 |
| Italy | 0.25 | 0.26 | 0.27 | 0.26 | 0.26 | 0.26 | 0.26 | 1.82 |
| *Cyprus* | 1.05 | 0.81 | 0.65 | 0.45 | 0.26 | 0.25 | 0.25 | 3.72 |
| *Latvia* | 2.4 | 2.41 | 3.26 | 3.68 | 3.84 | 3.94 | 4.07 | 23.58 |
| *Lithuania* | 2.68 | 2.58 | 3.4 | 3.63 | 3.74 | 3.82 | 3.93 | 23.78 |
| Luxembourg | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.16 |
| *Hungary* | 3.01 | 3.04 | 3.7 | 3.68 | 3.62 | 3.62 | 3.74 | 24.41 |
| *Malta* | 2.06 | 2.07 | 2.08 | 2.01 | 1.96 | 1.9 | 1.89 | 13.96 |
| Netherlands | 0.04 | 0.04 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.32 |
| Austria | 0.07 | 0.07 | 0.08 | 0.07 | 0.07 | 0.07 | 0.07 | 0.51 |
| *Poland* | 2.61 | 2.39 | 2.97 | 2.66 | 2.66 | 2.63 | 2.67 | 18.58 |
| *Portugal* | 1.76 | 1.75 | 1.81 | 1.79 | 1.81 | 1.8 | 1.81 | 12.52 |
| *Romania* | 1.07 | 1.37 | 2.22 | 2.54 | 2.63 | 2.59 | 2.67 | 15.09 |
| *Slovenia* | 1.6 | 1.53 | 1.65 | 1.67 | 1.67 | 1.64 | 1.64 | 11.4 |
| *Slovakia* | 2.37 | 2.18 | 2.42 | 2.52 | 2.62 | 2.63 | 2.63 | 17.36 |
| Finland | 0.14 | 0.14 | 0.15 | 0.14 | 0.13 | 0.12 | 0.11 | 0.93 |
| Sweden | 0.07 | 0.08 | 0.09 | 0.08 | 0.07 | 0.07 | 0.07 | 0.54 |
| UK | 0.08 | 0.09 | 0.1 | 0.09 | 0.08 | 0.08 | 0.08 | 0.59 |
| **Total** | **0.36** | **0.38** | **0.41** | **0.4** | **0.4** | **0.4** | **0.41** | **2.77** |

Note for both tables: Allocations per member state include all possible items under convergence, cohesion, regional competitiveness & employment and territorial cooperation, financed under the ERDF, ESF and Cohesion Fund. Countries in italics = n+3 countries.

domestic resources to cover an average of 20 percent of the total costs of convergence projects, as required under the co-financing principle[9].

### 3.1 Absorption by country

Data on outstanding funds as a proportion of each country's GDP provide a good indication of the potential role of EU Structural and Cohesion Funds for crisis management and resolution (see Figure 1). As they are a share of the initial allocation, outstanding commitments are obviously significant for the main beneficiaries of redistribution in the EU (ie CEE member states and some southern European countries). Among the euro area countries suffering most in the crisis, there is some variation. For Greece, outstanding funds are about 7 percent of GDP over the 7-year programming period. For Portugal, they come close to 9.3 percent of GDP. Spain has about 2.5 percent of GDP in usable financial resources, but Ireland only 0.4 percent of GDP.

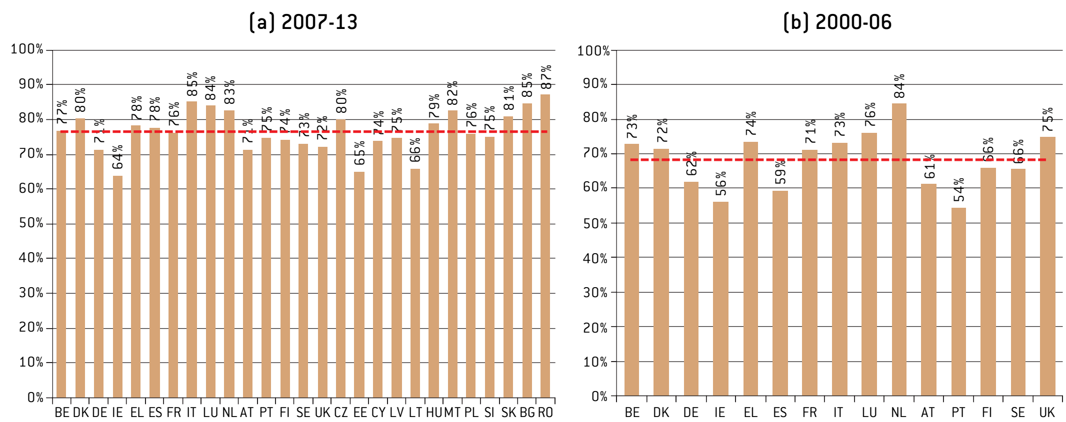
The problem of poor absorption is one of governance. Hence, varying absorption rates reflect differences in national institutional and political contexts. Figure 3 (a) shows the share of outstanding funds as a percentage of the total allocation for the period 2007-13. Most of the countries for which the n+2 rule was relaxed in 2007 are characterised by below-average absorption (ie the CEE member states and Greece). But the emergency changes to EU regulation that were introduced in response to the crisis are certainly just one part of the explanation. Denmark, Italy, Luxembourg and the Netherlands are also poor absorbers of EU funds.

Figure 3(b) allows comparison of the current situation with the previous financial framework. Three years after the beginning of the programme, undisbursed funds were higher-than-average in Belgium, Denmark, Greece, Italy, Luxembourg, the Netherlands and the UK. All in all, Figure 3 provides only limited support to the argument that poor access to EU funds is related to the difficulty of finding domestic resources for the co-financing of EU-funded projects in times of crisis and of imposed fiscal rigour. First, Denmark and the Netherlands underperformed in both the current and previous programmes, but they are not facing particularly tight fiscal constraints at home nor were they under strong austerity measures in 2000-06. Second, the Greek performance compares badly with that of other EU countries whether in times of crisis or not. The problem of poor absorption thus goes beyond concrete domestic fiscal constraints.

## 4 GOVERNANCE: ABSORPTION, OBJECTIVES AND DELIVERY

The empirical literature on the economic impact of EU Funds shows mixed results. On the negative or neutral side, Boldrin and Canova (2001) find that Structural and Cohesion Funds are on average ineffective. Checherita *et al* (2009) show that they help to reduce income disparities at the regional level but are incapable of promoting output growth[10]. Interestingly enough, Ederveen

**Figure 3: Outstanding commitments compared to initial allocation for 2007-13 at the end of 2010 (a), and for 2000-06 at the end of 2003 (b)**




Source: Bruegel based on European Commission data.

10. For a discussion of the problems associated with econometric growth regressions testing the role of Structural Funds, see European Commission (2004).

*et al* (2006) find that EU funds become effective only when accompanied by an appropriate institutional framework (ie strong institutional quality, lack of corruption, etc)[11]. All in all, there is no doubt that the economic success of EU funds is conditional on effective governance. In this respect, the following points deserve special attention: absorption; the identification of the objectives for which Structural Funds are used; and their actual delivery, which is the umbrella under which both absorption and objectives should be treated. We argue in fact that, depending on the type of project they support, Structural Funds may be better delivered in a centralised or in a decentralised manner.

### 4.1 Absorption targets

That EU countries have only poorly and slowly absorbed EU funds is not a new argument. Different types of absorption problems have been identified. On the demand side, national authorities have been unable to put together a sufficient number of projects eligible for EU funding. On the supply side, the co-financing principle has at times constrained countries that have weak fiscal planning capacity[12]. Moreover, poor administrative capacity has delayed or even impeded the execution of already approved projects.

As evident from Figure 1, available EU funds are a potential booster for economic revival in most CEE countries as well as in Greece and Portugal. In that respect, the funds potentially offer an important contribution to recovery and stronger long-term economic growth in these countries[13].

The European Commission has included higher absorption of EU funds as a condition for the disbursements of EU loans to three financially assisted countries: Greec e, Latvia and Romania. Latvia is expected to receive total funding of €7.5 billion, of which €3.1 billion will be under the MTFA scheme. Romania receives €20 billion, of which €5 billion is under MTFA. Disbursements to both countries started in 2009 and will continue until 2012. The adjustment programmes for Latvia and Romania require, as a condition for the disbursements, that governments implement various deficit-cutting measures but also put aside resources for the co-financing of EU projects, and demonstrate efficient spending of EU funds by meeting specific expenditure targets laid down in the adjustment programme itself. Greece, on the other hand, obtained a special loan of €110 billion, of which €80 billion is from the EU, and will be distributed between 2010 and 2013. As in the cases of Latvia and Romania, the economic adjustment programme for Greece contains a list of actions the Greek government should undertake in order to raise the absorption rates of Structural and Cohesion Funds. These include i) an accelerated process of selection and production of project proposals, whose results will be assessed based on the number of projects that are submitted to Commission services; ii) the establishment of a special central account that collects budgetary appropriations intended to co-finance Structural and Cohesion Funds; and iii) the creation of a special government task force that is in direct contact with the Commission services. All of these interventions address the most typical absorption problems already described above: lack of proposals, weak fiscal planning and poor administrative capacity.

Raising effective absorption is a valuable policy objective and should indeed represent one of the elements of conditionality in all financial assistance packages. Nevertheless, higher effective absorption alone is not sufficient. The key questions are if EU funds are used for the right projects and if they are successful in meeting the objectives for which they have been conceived. The first issue is resolved by identifying systematically a country's weaknesses and designing projects that will contribute to solving them. The second issue concerns the funds' delivery and is especially relevant for designing the next MFF.

### 4.2 Objectives: the right solution for the right problem

EU funds are mostly used under four different headings: i) infrastructure spending; ii) support to agriculture, industry and services; iii) investment in human capital; and iv) investment in R&D. Not all projects are worth embarking on. Higher absorption turns into an economic success only if the projects undertaken truly address the country's structural weaknesses and short-term needs. Hence, adjustment programmes for coun-

11. See also Santos (2008).

12. This is more than just facing fiscal constraints in austerity.

13. That EU funds have a stimulus potential was already recognised in the European Economic Recovery Plan (EERP), on the basis of which €6.25 billion was advanced from the EU budget to EU member states in the form of advance payments.

tries under financial assistance should not only include spending targets for EU funds that will incentivise absorption, but should also provide indications of how Structural and Cohesion Funds can and should be used[14].

For example, not all crisis countries have poor infrastructure or uncompetitive product markets or poorly skilled labour forces, or a weak capacity for innovation. It is crucial to identify priorities and provide EU countries with guidelines, whether rigid or soft, on the types of projects that can be implemented, and, if necessary, technical assistance to realise them. For example, in Greece, the railway system suffers from structural deficiencies and other bottlenecks; product markets are uncompetitive due to high entry costs; the education system is excessively rigid, R&D spending and, as a result, high-tech exports are well-below average. In Portugal, the labour force is poorly skilled and R&D spending is below the European average but not as low as in Greece. In Spain, there is a mismatch between skill demand and supply that needs to be addressed and, just like Greece, a problem of low R&D spending and poor competitiveness in high-added value sectors.

EU guidelines should not only consider each country's structural weaknesses, but also short-term needs including the necessity to counteract the recessionary impact of otherwise necessary fiscal adjustment. Different categories of EU-funded projects come in fact with different short- and medium-term economic impacts.

Table 3 provides a snapshot of how the four different project headings listed above can be modelled, and summarises the size and time profile of their macroeconomic effects. Measures supporting agriculture, industry and services reduce entry costs for firms and allow investment in tangible assets (eg machineries and equipment). They have very strong effects in the short-term and moderately strong effects in the long-term. Infrastructure spending is mostly modelled as government investment and tends to have a moderately strong economic effect in the short-run and in the medium-term. Investment in R&D also reduces entry costs for start-ups that would have been otherwise unable to finance themselves. The short-term impact is ambiguous and depends on the actual measures being introduced, but the long-term effects are significant. Investment in human capital comes as a form of government spending and its short-term impact is ambiguous, as it might be associated with negative immediate effects if workers are taken out of the labour market to be trained; however it has a very strong long-term impact[15].

Project selection should thus be based on an evaluation of both structural weaknesses and macroeconomic needs. Greece, for example, has committed to an ambitious fiscal consolidation plan that foresees discretionary measures from 2010 to 2013 worth 10.9 percent of national GDP, with 3.8 percent of GDP in revenue increases and 7.1 percent of GDP in expenditure cuts. The potential recessionary impact will be substantial[16]. The 7 percent-of-GDP EU funds still available to Greece should be absorbed by projects that address structural weaknesses and thus contribute to raising the country's potential output. But the funds should also combat the contractionary impact of such a far-reaching fiscal retrenchment. In view also of the significant frontloading of fiscal consolidation, preference should be given, for example, to measures that support agriculture, industry and services (eg IT support services to firms) and to the required infrastructure spending. R&D and human capital investment are crucial to the economic survival of Greece and can be put in place after the strong initial fiscal effort has been relaxed.

Table 3: Size and time profile of macroeconomic effects of funds, by project type

| Project type | Modelled as | Short term | Long term |
|---|---|---|---|
| 1. Support to agriculture, industry and services | Low entry costs and capital cost for tangible investment | ++ | + |
| 2. Infrastructure spending | Government investment | + | + |
| 3. R&D Investment | Low entry costs and capital cost for intangible investment | +/- | ++ |
| 4. Human capital investment | Government spending | +/- | ++ |

Source: Bruegel based on results from Dynamic General Equilibrium (DGE) model in Varga and in't Veld (2010).

14. Under the Marshall Plan, funds were actually disbursed only on acceptance by US authorities of individual projects.

15. The snapshot is an adaptation of results obtained in Varga and in't Veld (2010).

16. Our calculation is based on IMF estimates of the contractionary effect on output of expenditure- and revenue-based fiscal consolidations (IMF, 2010).

The European Commission should indeed select a limited number of priorities from those identified in the already approved operational programmes, making sure they are consistent with the main messages in the new Annual Growth Survey, the country-specific Broad Economic Policy Guidelines (BEPGs) and the EU2020 strategy. It should also offer technical assistance on the ground. The next question is, however, if these measures can be really implemented while absorption remains poor. For certain types of projects, absorption problems may be harder to eradicate. This poses the question of delivery.

### 4.3 The delivery of EU funds

The governance of Structural and Cohesion Funds is a matter of shared competence between the EU and the member states. Priorities and the Operational Programmes (OPs) are negotiated between the European Commission and the member states but the implementation of OPs is managed by member states.

For certain types of projects, however, absorption problems in individual member states are difficult to overcome. One example is spending on infrastructure. This is a policy area where EU funds are typically used under strong political incentives due to the high visibility of projects and because of the role of public procurement. Moreover, infrastructure projects are more likely to be delayed because complex public procurement regulations often require time-consuming ex ante procedures such as environmental impact assessments or because the co-financing principle requires national governments to have large amounts of available domestic resources to get them started.

Quite appropriately, a special status is granted to projects with a total cost of more than €50 million in the area of transport and energy infrastructure, because member states need to conduct *ex ante* cost-benefit analyses, which must be approved by the Commission before spending can start. However, an amending regulation introduced in 2009 allowed member states to start spending even before the Commission's green light[17]. In fact, this is an area in which it would have been desirable to temporarily centralise delivery by delegating the management of EU funds to the Commission and creating a body similar to the Trans-European Transport Networks Executive Agency, to manage the funds and implement projects to the benefit of crisis countries[18]. In this scenario, there would be no need to maintain the co-financing principle as a means to preserve the good quality of projects.

## 5 THE SIZE AND DISTRIBUTION OF EIB LOANS

EU member states have also the option of applying for EIB loans and guarantees to finance on favourable terms large-scale projects and programmes. The EIB's strategic objectives include, among others, fostering convergence, offering support to small and medium-sized enterprises (SMEs) and sustaining the development of alternative energies. To some extent, they overlap with the goals of Structural and Cohesion Funds. Yet, the nature of the available funds and the delivery structure are clearly different.

The EIB funds are not aid but loans granted on 'reasonable terms'; the quality of the proposed projects is evaluated in depth; and technical assistance is often provided for the project's planning and execution. The loans are generally easier to activate than EU funds, and can cover up to 50 percent of a project's total costs, reflecting a co-financing principle, as is the case with EU funds. Loan finance can be combined with EU grants, and there has in fact been increased use of EIB loans to pre-finance EU-funded projects or to just match co-financing[19].

Currently outstanding EIB loans amount to about €344 billion[20]. Distribution varies across member states. The recipients of the largest volumes of loans are Germany, Italy and Spain. The EIB Statute formally rejects the concept of national quotas. Nevertheless, there is a strong country-size dimension, with large EU members receiving more than small countries, because of the number of potential applicants or because larger states have been more involved in expensive Trans-European Networks projects.

Figure 4 compares each member state's share of EIB loans (2006-10) to its share of total Structural and Cohesion Funds (2007-13). Three clusters of countries can be isolated. The most populated one consists of countries that receive relatively less

17. Council Regulation (EC) 284/2009 amending Regulation (EC) 1083/2006 (General Regulation), 7 April 2009.

18. The Trans-European Transport Networks Executive Agency was created in 2006 to implement and manage the TEN-T programme on behalf of the Commission.

19. EIB loans have been also used to finance technical support to improve EU funds absorption. An example is JASPERS, a joint initiative of the European Commission, the EIB and the EBRD to provide this type of technical support to the 12 Member States that joined the EU between 2004 and 2007.

20. The EIB's shareholders are the EU member states. Their contribution to subscribed capital is a function of their economic weight in the EU. As of March, 2009, the subscribed capital of the EIB was 232,4bn EUR. As the Bank's Statutes fixes an upper bound on its leverage ratio of 2.5, there is still about 240bn EUR available for loans.

of both cohesion grants and EIB loans. The group is composed mainly of small countries. Ireland belongs to this group. This is unsurprising in the case of Structural Funds and Cohesion Funds, as the allocation method foresees that funds are distributed according to relative income per capita multiplied by the population of each region and by the surface area. On the other hand, small countries' limited access to EIB loans is less self-explanatory. It could be related to the potential number of applicants, or their more modest involvement in large Trans-European Networks, but it could also be that poor access to EU grants is limiting the need and the opportunity to apply for EIB loans that pre-finance or co-finance EU-funded projects. The second cluster includes countries that receive more in loans than they do in EU grants. Spain is one such example and is in fact the recipient of the most EIB loans. Finally, the third cluster consists of countries that receive relatively more in Structural Funds than in EIB loans. Greece belongs to this category.

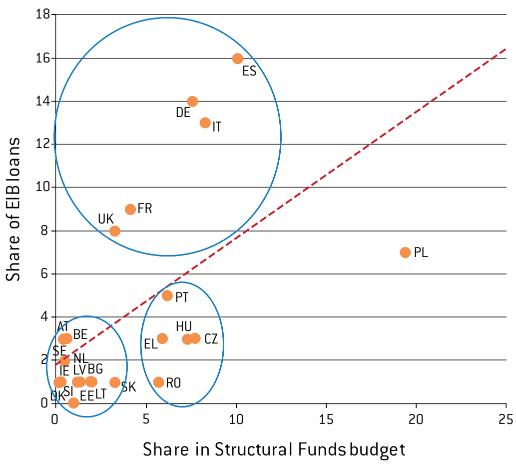
There is thus suggestive evidence that countries exploit (or are unable to exploit) synergies between grants and loans. To check for its robustness, we compare each member state's share of total Structural and Cohesion Funds (2007-13), as above, with its share of EIB loans that co-finance projects already supported by EU funds (2006-10). We find a positive relationship between the actual availability of EU funds and the practice of using EIB loans in conjunction with EU grants. Spain is an exceptionally active applicant for EIB loans, and is arguably much more capable than others of exploiting synergies between European loans and grants to support large infrastructural projects. In Greece, on the other hand, there is room for improving the use of loans from either the EIB, or more generally from private investors, to co-finance already EU-funded projects, given the low incidence of projects financed and funded by both the EIB and the EU budget (see the vertical axis of Figure 5).

## 6 SOME POLICY RECOMMENDATIONS

The EU in the past could afford to manage its development funds without much regard to their macroeconomic effects. At a time when the southern part of the euro area is struggling and badly needs policy instruments for economic revival, this has become an unaffordable luxury. Some EU countries have large amounts of usable Structural and Cohesion Funds. We suggest that these are put to good use within the framework of a temporary 2011-13 European Fund for Economic Revival (EFER). The Commission could administer this fund directly with the support of an executive agency on the model of the Trans-European Transport Networks Executive Agency. It is a welcome development that the adjustment programmes of Greece, Latvia and Romania mention a higher absorption rate of EU funds as one of the elements of conditionality. But absorption per se is not sufficient to deliver economic growth.

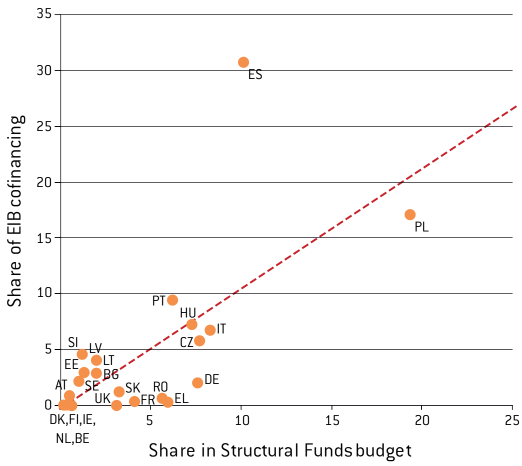
**EU funds should turn into a booster fund for eco-**

**Figure 4: Access to Structural Funds relative to access to EIB loans**




Source: Bruegel based on European Commission/EIB data.

**Figure 5: Access to Structural Funds relative to EIB cofinancing**




Source: Bruegel based on European Commission/EIB data.

**nomic revival in crisis countries.** In particular, adjustment programmes negotiated with financially assisted countries should include precise references to the types of projects that need to be financed, taking account of the target countries' structural weaknesses and of short-term needs recognising the funds' countercyclical function.

**The European Commission should be empowered with the direct management of certain types of projects.** The delivery of projects such as local infrastructure spending listed in the OPs should be temporarily delegated to the European Commission and carried out by an special inter-service task force involving the Directorate General for Economic and Financial Affairs, as the latter is in charge of conditional assistance. Under this scenario, co-financing by member states may be temporarily suppressed.

**The EU should promote the use of flexible EIB loans and should strengthen synergies with the EU budget.** The evidence seems to be that recipients of small amounts of Structural Funds also apply for small amounts of EIB loans. Small countries are in turn less able to exploit positive synergies between the two instruments. While the EIB finances more than 50 percent of a project's total costs under exceptional circumstances only, it should apply this rule to small member states such as Ireland or Portugal, and especially those in difficulty.

**There is room for using the EU budget to leverage financing for strategic investments by the private sector with the support of the EIB.** The EU budget can serve the purpose of improving credit ratings and of thereby obtaining support from the private sector for financing cohesion-enhancing strategic investments in Europe[21].

21. The idea of strengthening synergies between public and private funding is well present in the Monti Report and in the latest European Commission's Communication of 19 October 2010 on the EU Budget Review.

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