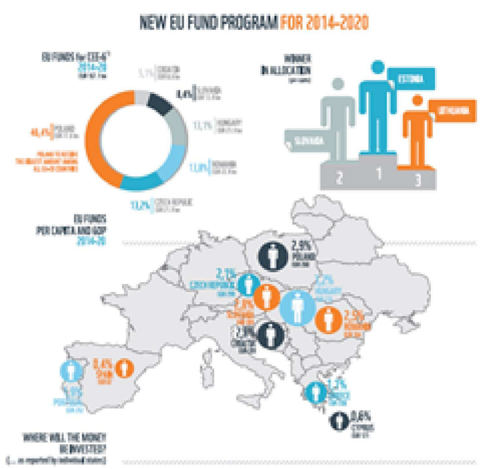
EU Cohesion Policy 2014-2020: Will EUR 167bn of EU funds give CEE a boost?

11.03.2014

EUR 167bn of EU structural and investment funds allocated to CEE-6 for 2014-2020 - approx. half of the total EU funds

A 90% absorption rate in CEE-6 would spur average GDP growth by 0.3-0.8pp per year

Poland receives the highest total amount of all EU-28 members; Hungary is winner in terms of total allocation/GDP; Slovakia ranks second as to average annual allocation per capita



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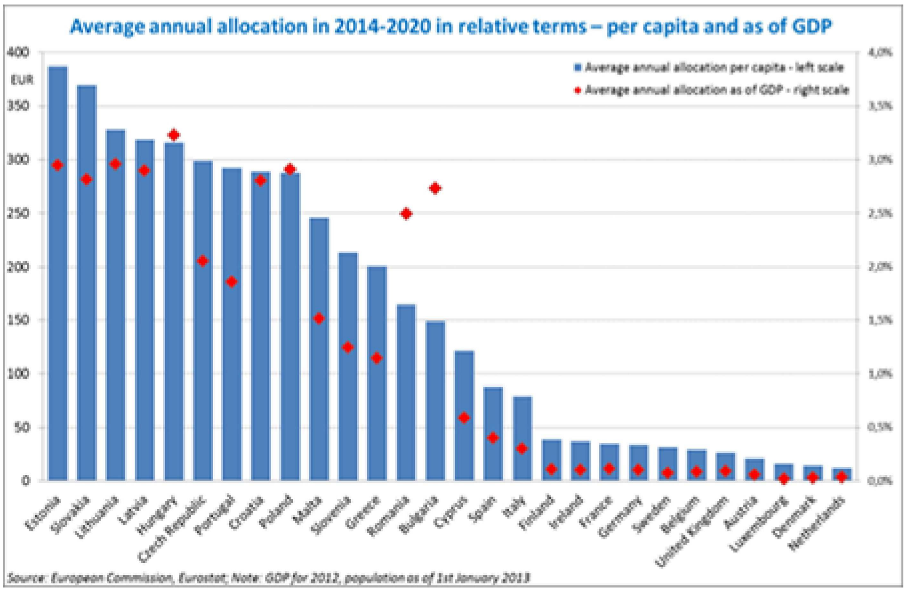
Erste Group analysts highlight transport, infrastructure, education and R&D as high-priority sectors

Poland had the best absorption rate (67.9%) of the 2007-2013 EU funds; Romania had the lowest EU funds utilisation (37.8%)

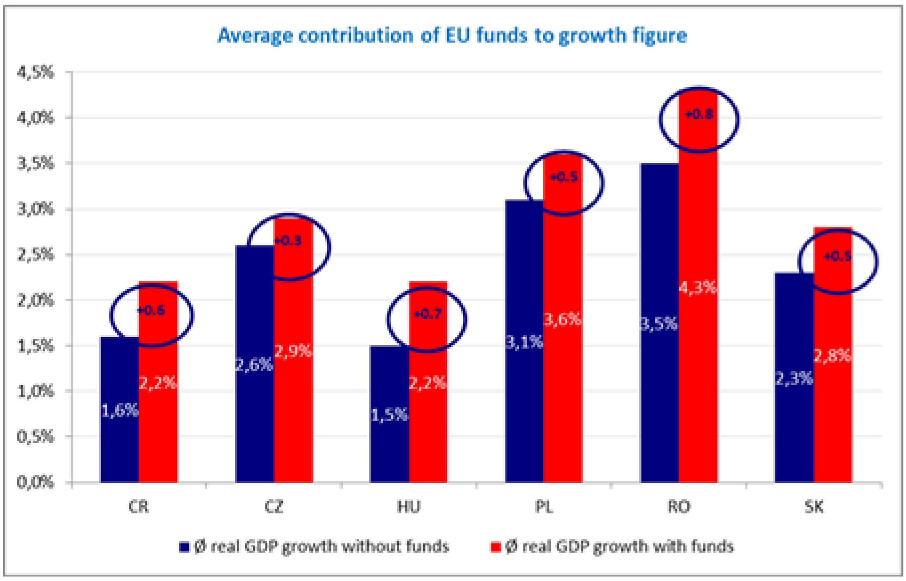


European Union's financial assistance to Central and Eastern Europe via the EU Cohesion Policy 2014-2020 could reach the scale of a "Marshall plan" for the region, finds the recently published Erste Group analysis conducted by the EU Office of Česká spořitelna in cooperation with Erste Group Research.

The total amount of structural and investment funds for the period 2014-2020 stands at EUR 351.9bn, which is 1.3% higher than in 2007-2013. "CEE-6 countries were allocated about half of the total EU funds pie, to the tune of EUR 167.1bn, which is 11% more than in the period 2007-13", says Jan Jedlička, Head of EU Office at Česká spořitelna and author of the report.

On top of that, the autonomous Connecting Europe Facility (CEF) will additionally support strategic projects in transport, energy and telecommunication infrastructure. The facility will enable the implementation of several significant projects in individual states, with cross-border impact and total approved allocation volume of EUR 33.3bn.

"Assuming CEE-6 would manage to absorb 90% of the newly allocated funds, this would add 0.3-0.8pp to the annual GDP growth. Moreover, if the countries successfully use their EU funds, the gap between them in terms of stage of development should steadily diminish. However, CEE countries have a long road ahead in terms of improving their still low absorption capacity. To achieve that, they need to significantly reduce bureaucracy, introduce more transparent processes of project selection, and establish closer regional cooperation," highlights Jedlička.



Poland is the winner of the tough negotiations over the billions of Euros of EU funds. The biggest economy in CEE should receive EUR 77.6bn, which is approx. half of the overall CEE pie and the highest total amount among all EU member states. Moreover, Poland is one of the few countries that managed to get an even higher allocation from the EU Cohesion Policy 2014-2020 than from the previous one in 2007-2013.

In terms of the annual allocation per capita – a more representative indicator – Estonia leads the pack with roughly EUR 387 per capita per year, followed by Slovakia with EUR 369. In terms of annual average allocation/GDP, the biggest amount of EU funds should flow to Hungary (annually 3.2 % of GDP), ahead of the Baltics (2.9-3.0% of GDP).

Golden rule: the more developed, the less money
In general, the more developed a country's economy, the less money it will receive from EU structural and investment funds. However, Romania and Bulgaria, as the least developed members of the EU, were allocated a lower total amount of EU funds than they should have been. To balance that, the two countries will also receive financial assistance from other European programs, such as the Common Agriculture Policy. These policies combined should provide them with a sufficient amount of subsidies.

Significant room for improvement in absorption rates – excessive bureaucracy is major hurdle
Among the CEE-6 countries, only Poland managed to draw two thirds (67.9%) of its EU funds allocated for the previous 2007-2013 period as of the end of 2013. The Baltics are regional champions in EU funds utilization. Hungary (59.3%), Slovakia (52.6%) and the Czech Republic (51.1%) managed to absorb more than half the EU funds they were allocated while Romania lagged behind with 37.8% of funds utilised. However, the country is still a newcomer, as it joined the European Union only in 2007. "Romania's poor absorption track record could be caused by the lack of experience and weak performance of the public administration. However, it still has an opportunity to work on it due to the 'N+3 rule' that gives the country three more years to spend the money allocated for the previous period", adds Jedlička.

European Commission should regularly disclose improvement in absorption rates
In order to prompt CEE countries to make full use of the EU funds in 2014-2020, the European Commission should start playing the "blame and shame" game. Although the EC gathers all relevant information regarding absorption rates in individual member states, it does not go on to publish the findings on regular basis. The EU Office of Česká spořitelna finds that publishing the absorption results on a regular and frequent basis would increase public pressure and determine countries to tackle their obstacles more effectively.

"Many CEE countries have a lot of operational programs run by too many authorities – this makes the whole system too complicated for final recipients and discourages some of the potential applicants. This could be improved by a fair and more transparent distribution of funds," states Jedlička. In countries like Poland and Slovakia, highly bureaucratic procedures associated with the projects are probably the most common disincentive to start the application process in the first place. The long periods of time spent on project assessment and contracting is another challenge for some CEE countries (mainly Romania) for the future programme period 2014-2020. CEE countries that find themselves facing similar obstacles should intensify regional cooperation by sharing best practices or benchmarking.

Where should the CEE-6 invest their newly allocated EU funds?

Poland: The total allocation from EU funds adds up to EUR 77.6bn, which is EUR 288 per capita and 2.9% of GDP. The biggest share of the subsidies (slightly more than one third) will be invested in infrastructure and environmental projects. Poland will continue to build the S7 road between Cracow and Warsaw and further Gdansk, for which around a EUR 1.7bn subsidy was previously budgeted. This infrastructure project, along with others, would ultimately result in express road and railway network connecting all major Polish cities. Development and education are next in the queue, as there are around 15% of all subsidies planned for projects in these two areas. A new, bottom-up approach should encourage the entrepreneurs to take advantage of roughly EUR 8.6bn to increase their investment in R&D. These projects can help the economy to transform from a catching-up stage to balanced growth based on innovation. EUR 4.1bn should be invested in education and training in order to promote employment and improve labor market conditions especially for young people as youth unemployment rate exceeds 25%.
CEF Program: Further improvement in the road and railway network is crucial for Poland as it increases the attractiveness of the country as the investment destination. Erste analysts believe that the Baltic-Adriatic corridor is one of the most important projects, as it will improve not only domestic infrastructure but also cross-border connections. Moreover, that corridor is connected to other important traffic routes and has a potential to become an efficient transport chain for Central Europe not only in terms of passenger traffic but also for the flow of goods. Analysts believe that the project will stimulate the economic development of the regions along the corridor.

Czech Republic: The total allocation from EU structural and investment funds in 2014-2020 is EUR 22bn, which is annually EUR 299 per capita and 2.1% of GDP. According to Erste analysts, the biggest share of subsidies should go to infrastructure projects, mainly in the area of transport, with earmarked almost one third of the allocation. Projects supporting R&D should receive one fifth of the allocation for the Czech Republic.

Roughly the same amount should go to environmental projects while one tenth of the EU funds should flow into the business sector (mainly SMEs). Around 15% of the total allocation should be invested in tackling labor market, social inclusion and work-life balance issues.
CEF Program: "The highest potential can be seen in the modernisation and increase of the transport capacity of the railway Nürnberg – Prague, as well as Munich – Prague. For the Czech Republic as an export-oriented economy, the modernisation of railway connection to Germany would further support trading ties between these two countries as Germany accounts for a third of the total Czech exports," highlights Jedlička.

Hungary: The total allocation from EU funds amounts to EUR 21.91bn, meaning annually EUR 316 per capita and 3.2% of GDP. The areas targeted by the Planning Office of National Economy are employment and mobility, as well as improving competitiveness of SMEs. The government announced that about 60% of EU funds should directly support economic development and employment. Only about 7% will be allocated to education, improving skills of the labor force and fostering life-long learning. Given that one of the biggest bottlenecks for Hungary's economy is caused by inadequate skills and education, this area deserves more attention, Erste analysts find.
CEF Program: Erste analysts highlight those projects that improve the north-south cross-border infrastructure, such as the Budapest-Zvolen road improvement, or the Budapest-SRB border rail. Tackling these infrastructure bottlenecks could help strengthen local businesses, which would get an easier access to a larger, regional market. Improving north-south energy infrastructure bottlenecks can also help to further diversify energy supply alternatives in the region.

Slovakia: The total allocation from EU funds is EUR 14bn, amounting to annually 369 EUR per capita and 2.8% of GDP. The number of operating programs is expected to decrease to nine over the next period and funds are likely to be redistributed in order to improve the rather weak absorption rate. Infrastructure will be the main priority for 2014- 2020, as the highway network is still far from complete. This is perceived as a major obstacle in attracting foreign investors to the eastern part of the country. Hence, 26% of the total EU funds allocated for Slovakia will be used for infrastructure projects. In a country with the 6th highest unemployment rate in the EU, projects that tackle long-term and youth unemployment are likely to get more funding (13%). Other priorities include Environment (20.6%) and R&D (14.5%).
CEF Program: Erste analysts consider the JANAF-Adria pipelines to be the most important projects. The pipeline reconstruction and expansion could further improve the energy security of Slovakia (which has been traditionally dependent on the Russian oil transported via Ukraine through the Druzhba pipeline). On top of that, the increased capacity would likely result into higher transit volumes and higher revenues for the country. Slovak refineries could additionally benefit from the possibly lower costs of crude oil.

Romania: The total allocation from EU funds is EUR 22.99bn, resulting in annually EUR 164 per capita and 2.5% of GDP. The biggest share of the pie will go to environment and transport (over 20% each), but less than 8% was earmarked for education. According to Erste analysts, education and health are two key areas that should benefit from more funds, as those two sectors are heavily under-financed. Medical services are in a poor condition struggling, caused by brain drain and a lack of medical equipment in public hospitals. As for education, an increasingly higher number of primary schools in the rural area are being shut down, which increases dropout rates. Higher and more efficient funding for health and education should be key priorities, given that Romania needs to increase its R&D spending from 0.5% of GDP in 2012 to 2% of GDP by 2020.
CEF Program: The rail project Arad – Brasov – Bucharest – Constanta that will connect the western border of Romania with the Black Sea coast on the eastern border would make a major contribution to economic growth. Reduced transportation time for freight and passengers should encourage foreign investors and local entrepreneurs open new businesses in Southern and Eastern Romania, areas that were somewhat neglected until now due to poor infrastructure. At the same time, this could be an important step in the strategy of the Romanian government and private business sector to revive tourism on the Black Sea coast and improve the service balance in the current account.

Croatia: The total allocation from EU funds amounts to EUR 8.61bn, which is EUR 289 per capita and 2.8% of GDP. Erste analysts believe that transport infrastructure, most notably railways and ports, is a key area that needs to be improved. Another important segment where more funds should be drawn is energy efficiency and renewable sources of energy. Fund implementation would also make an impact on the development of IT infrastructure, by extending the broadband internet coverage or projects such as e-Healthcare or e-School i.e. public services upgrade to improve competitiveness.
CEF Program: The railway project from Rijeka – Zagreb – Hungarian border would be, according to Erste analysts, a clear upgrade of the existing infrastructure aiming to connect the northern Adriatic, most notably the port of Rijeka, to Zagreb (potential logistics hub) and farther away to Hungary and CEE. Additionally it would allow the port of Rijeka to expand significantly, given the geographical competitiveness and removed bottleneck close to Rijeka. Logistics and transport industries would benefit from the project in the long run.

“Horizon 2020” – the EU budget for Research & Development

In addition to the structural and investment funds, the EU allocated a seven-year-budget worth nearly EUR 80bn for “Horizon 2020” – the largest research and innovation program of the EU. There are no pre-defined national allocations for individual member states. Therefore, projects from all EU member states have to compete to receive the support from the “Horizon” program. The program to support R&D in 2014-2020 is built around three pillars: Support for Excellent Science (including grants from European Research Council for top scientists, Marie Curie fellowships etc.), support for Industrial Leadership with grants for SMEs as well as support for research to tackle societal challenges in the area of health, energy efficiency, sustainable agriculture and transport etc.

Report [pdf; 683.7 KB]