Chapter 6

EPILOGUE: POLICY LESSONS FOR THE FUTURE

According to economic theory and empirical findings, a country that experiences a low rate of growth and a relatively low public to private capital ratio can generate higher growth by increasing public capital formation. Increased infrastructure raises the marginal product of private capital and induces private investment. Thus, the country can attain a higher long-run growth rate of output. This justifies the use of transfers for public capital formation promoted by aid policies, which aim at fostering growth in less developed countries. An inflow of funds for public capital formation will speed up the process of growth and convergence.

In the case of the CSF funds inflows to Greece, the universal conclusion reached here is that in the absence of positive supply-side effects generated by CSF actions, all types of these actions produce only a temporary rise in activity and employment. The estimates presented here show that, under certain assumptions, a fall in output growth rate accompanies the cessation of the programme. So, after the implementation period, the economy returns to the course that would have been the case without the funds. A permanent rise in growth, activity and employment is achieved only when CSF generates positive supply-side effects.

Such a conclusion may not be seen as surprising, given the disappointing experience of the first CSF. Being allocated mainly to a multitude of small-scale projects and uncoordinated actions, and driven mainly by the haste to absorb funds the first CSF had few lasting effects. The economy grew faster in 1990 and 1991, but then activity slackened. A similar picture emerges as a possible outcome for the second CSF if the effects are left to operate only through the demand side.

However, if supply-side effects are assumed to operate even at a moderate scale, the picture changes starkly. Total output will be rising for a long period of time, and a decade after the end of CSF the economy will still be growing at a faster rate than in the absence of EU financing; productivity, employment and the exporting capacity of the country will improve accordingly.

This finding has far-reaching implications for the allocation, implementation and monitoring of the Plan, since it calls for actions that ensure the maximum possible efficiency if a lasting improvement is to occur in the economy. National and EU authorities should make sure that the following conditions are satisfied in order to achieve the supply-side effects envisaged in the ex ante analysis of CSF:
design, construction, and operation of hard infrastructure projects after a careful examination of the benefits that are going to accrue to the various sectors of economic activity. The hard infrastructure actions of the Regional Programmes should be implemented in conjunction with national-scale ones so that supplementarity rather than repetition is achieved.

the implementation of soft infrastructure actions should take into account the demand that is likely to develop for such services (e.g. R&D, culture, health, etc). The concentration on top-down activities that cannot attract substantial demand from the production and service sector should be avoided.

training and education should be geared to providing skills in current and future demand by the economic activities, so that their effect is felt on improving the productivity of the human factor.

the implementation of the Programme should ensure that all envisaged co-financing by the private sector is realised, so that the maximum impact on investment and infrastructure utilisation is achieved.

An important question that arises though is whether the increased growth rates implied by such policies could be sustained after the ending of transfers from abroad. The ending of transfers will be associated with a higher output level and a higher public capital stock. But in order to maintain the increased growth rates the recipient country will have to continue financing permanently higher public investment through domestic resources or, otherwise, it will experience a ‘hard landing’ effect at the terminal period.

It seems that, given the nature and size of Plans financed by Structural Funds (which involve mainly large-scale projects), the private sector would never engage in financing this type of infrastructure investment; however, increased infrastructure raises the expected return of private capital and induces private investment. Therefore, in the case of Greece, aid via Structural Funds is of crucial importance for achieving the goal of real convergence with the rest of the European countries.

Financial assistance through Structural Funds in Europe becomes more important in light of the regional policy reforms agreed in March 1999 in the Berlin Summit. European leaders agreed to allocate 213 bn Euros to funds for regional aid from 2000 to 2006 comparing to 203 bn Euros over the 1993-1999 period. The allocation among member states shall be based on the percent of population eligible for assistance, on regional and national welfare criteria and the degree of structural deficiencies, and particularly unemployment. In particular, Greece is expected to receive 24.9 bn Euros for the 2000-2006 period, compared to 21.9 bn Euros for the 1993-1999 period.

An important question that remains open, though, concerns the fungibility of foreign assistance. If an investment project would be
undertaken even in the absence of foreign financing, then foreign aid may release resources for other purposes, thus ending up in financing undesirable activities (Devarajan and Swaroop, 1998). Therefore, foreign aid should not alter public investment policies, but rather increase the amount available for investment. This will increase the rate of return on infrastructure and overall utility, as it may allow the design and implementation of larger-scale projects.

Financial assistance of the type provided by the Structural Funds can also improve the social infrastructure of the economy. Hall and Jones (1999) argue that the large variations in output per capita across countries can only partially be explained by differences in physical and human capital. On the contrary, these authors show that social infrastructure, in the form of ‘...institutions and government policies that determine the economic environment’, plays a crucial role in explaining variations in per capita income. The legislative and institutional framework affects the level and productivity of key inputs and provides favorable conditions for sustainable development.

To this extent, assistance through the Structural Funds provides a stable framework for long-term growth by promoting a number of institutional changes and structural reforms in critical areas of economic activity. Also, public consensus on the beneficial role of the EU in these countries underlines the usefulness of membership and renders the acceptance of common European policies easier.

Today, a large regional market of 60-70 million people in South-eastern Europe is being shaped, with significant opportunities for co-operation and trade. The main characteristic of this new market is potential economic relations between bordering countries. This opportunity is related to the prospect of re-composing the economic space in its vicinity with the creation of a regional Balkan market, in which it will have a central and highly influential role. For the first time in the post-war period, a real opportunity is given to the Balkan countries to interact without political or military barriers, leaving the level and type of their trade relations to be determined by markets and geography.

Therefore, as regards the EU and Structural Funds, policies promoting economic unification and coherence of the South-eastern European economic space are necessary and should include support for the following:

- encourage all Balkan countries to the perspective of joining EU, according to the progress they make.
- promote a strategic development plan for the Balkan region at various regional and sectoral levels with emphasis on intra-regional co-operation and integration. This plan should include the financing of
transportation and telecommunication networks that will allow the integration of existing development areas in the Balkans and reveal the role of South-eastern Europe as an emerging regional market with significant size, strong intra-regional relations and efficient infrastructure, providing a strategic advantage for boosting EU economic relations in the Black Sea, Eastern Mediterranean and the Middle East regions.