

Interreg Knowledge Fair

Inflation – the unwanted driver in PLC.

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Interact



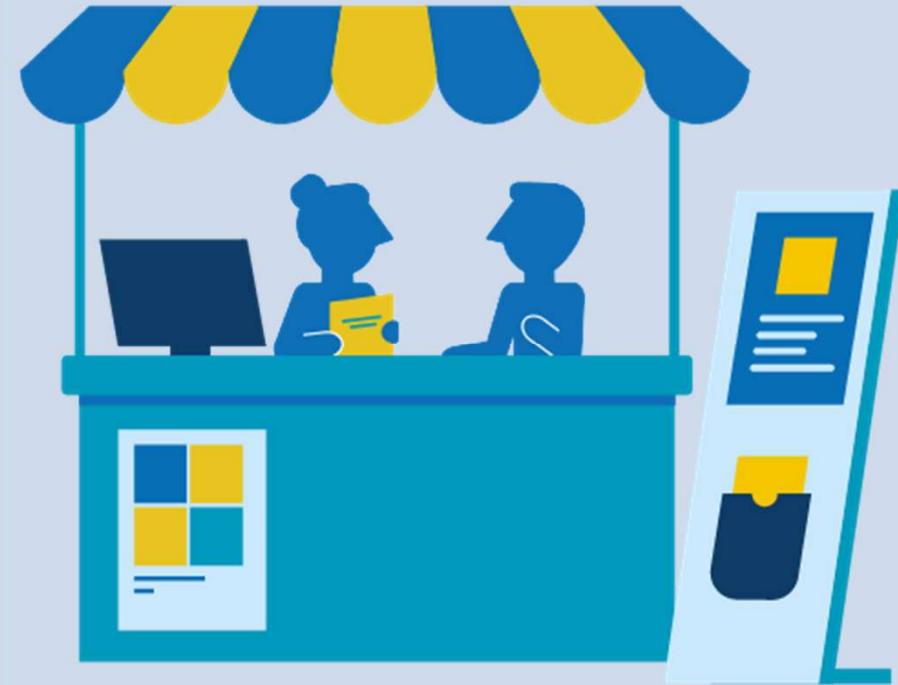
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Welcome to the Interreg Knowledge Fair

This is a **pilot activity** for Interact, testing a new approach to our service delivery – and **whether it works for you!**

While you are here, you will be asked to **rate individual sessions** (in Whova) and to respond to a **4-question survey** at the end of each day.

Please share your feedback with us!



Plan

01

Setting the scene – initial considerations

02

Further considerations and Discussion

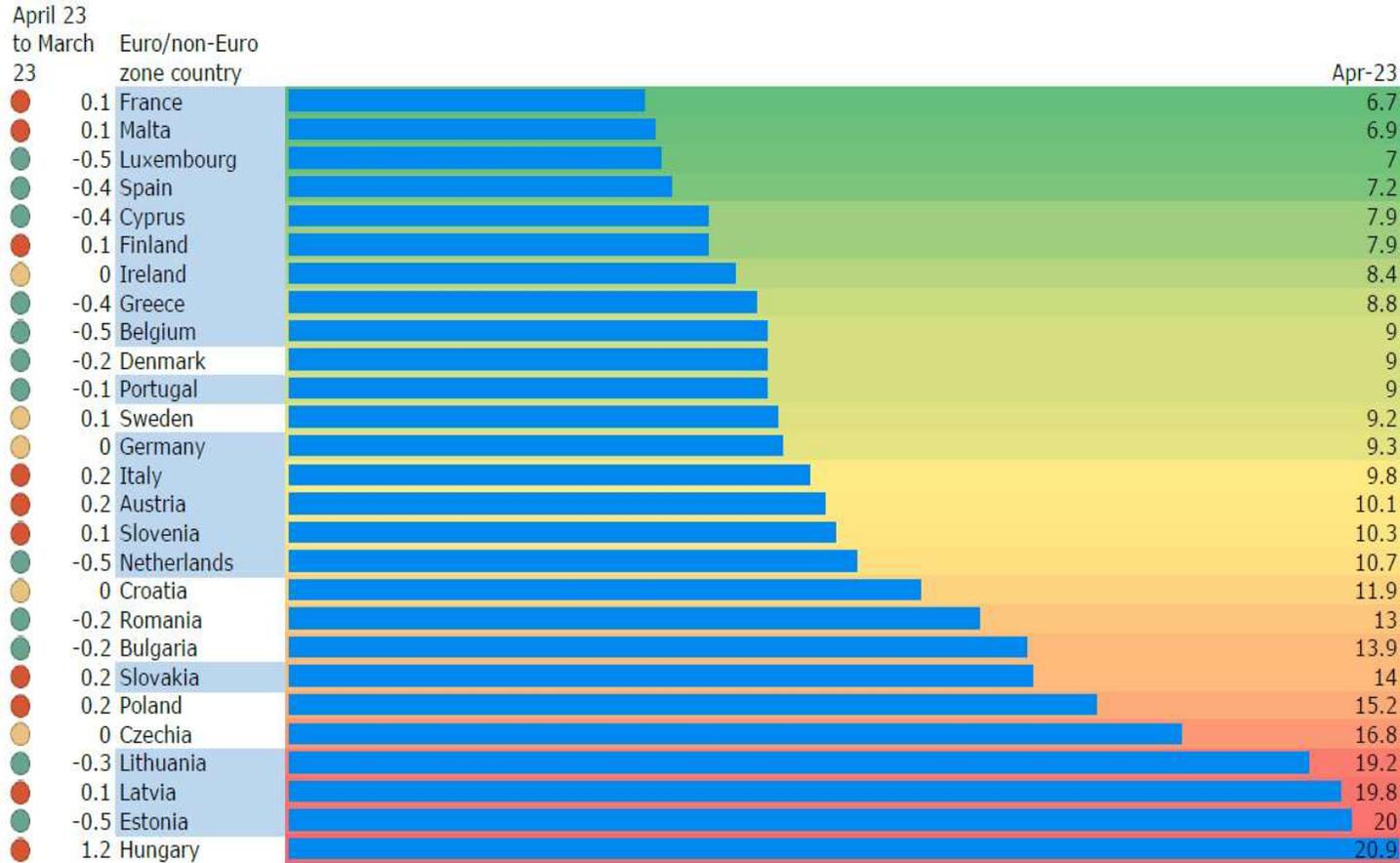
03

Wrap-up

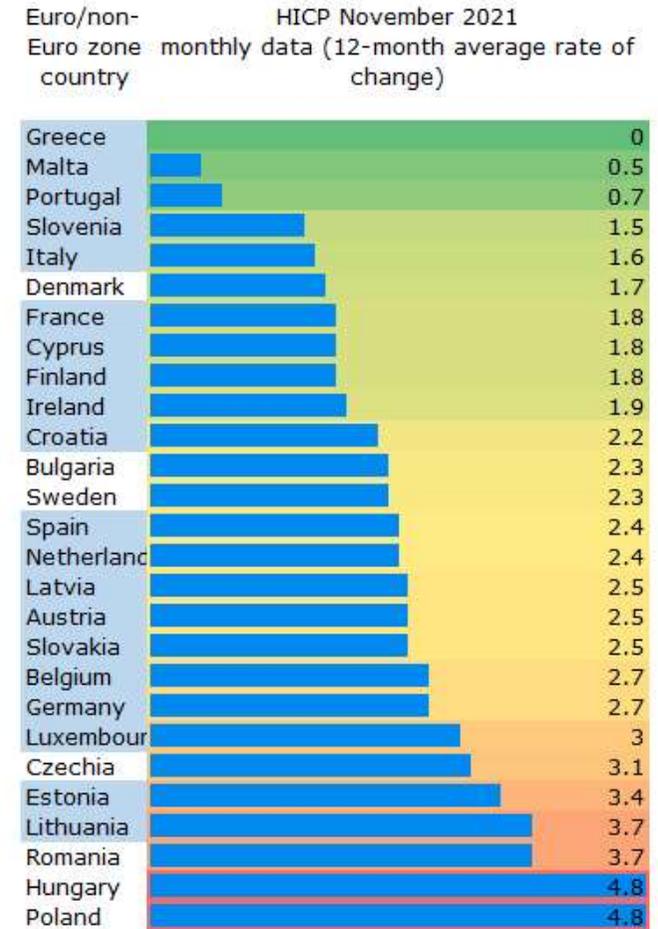
Inflation

HICP- monthly

April 2023

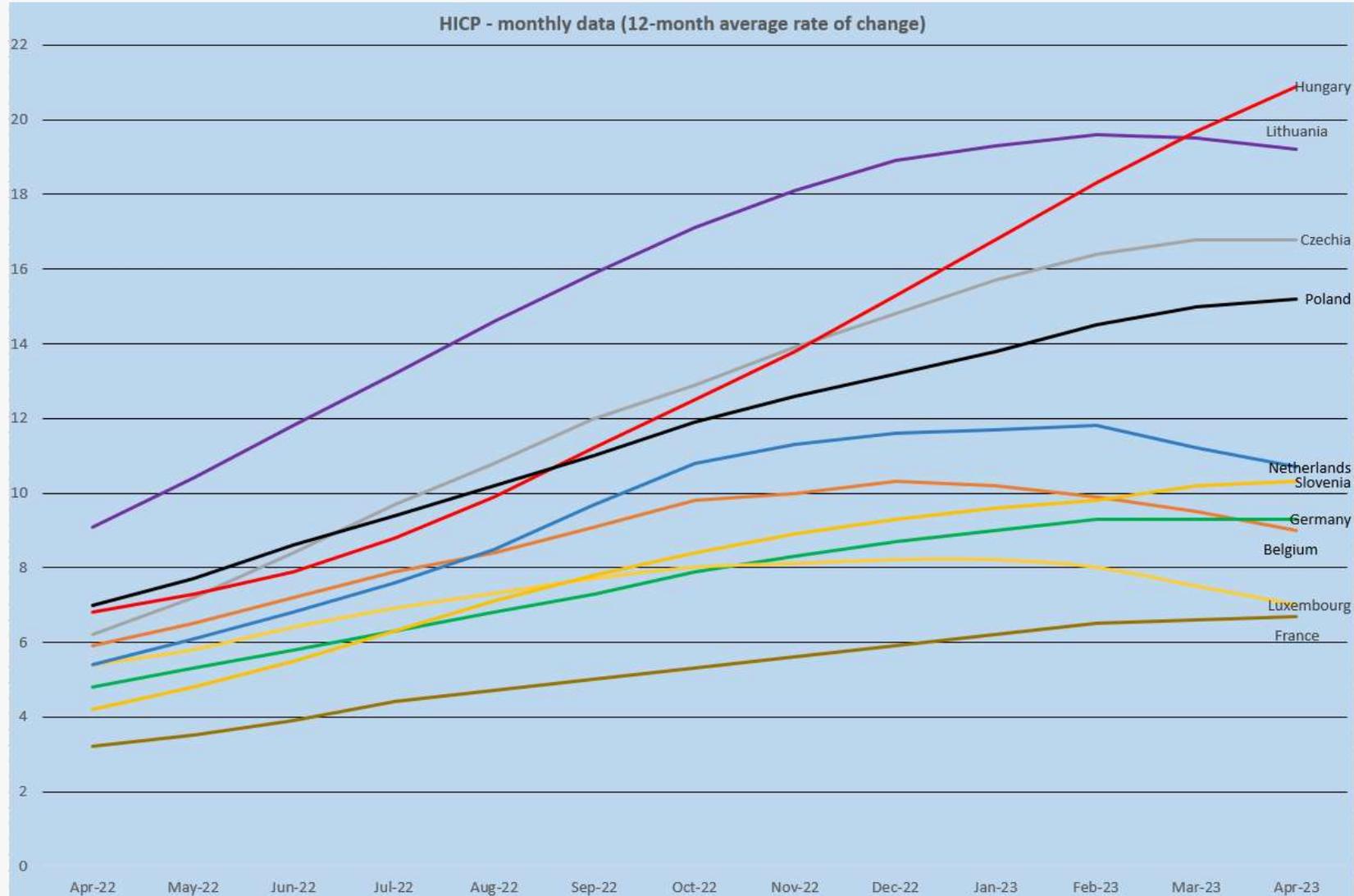


source: Eurostat



Inflation

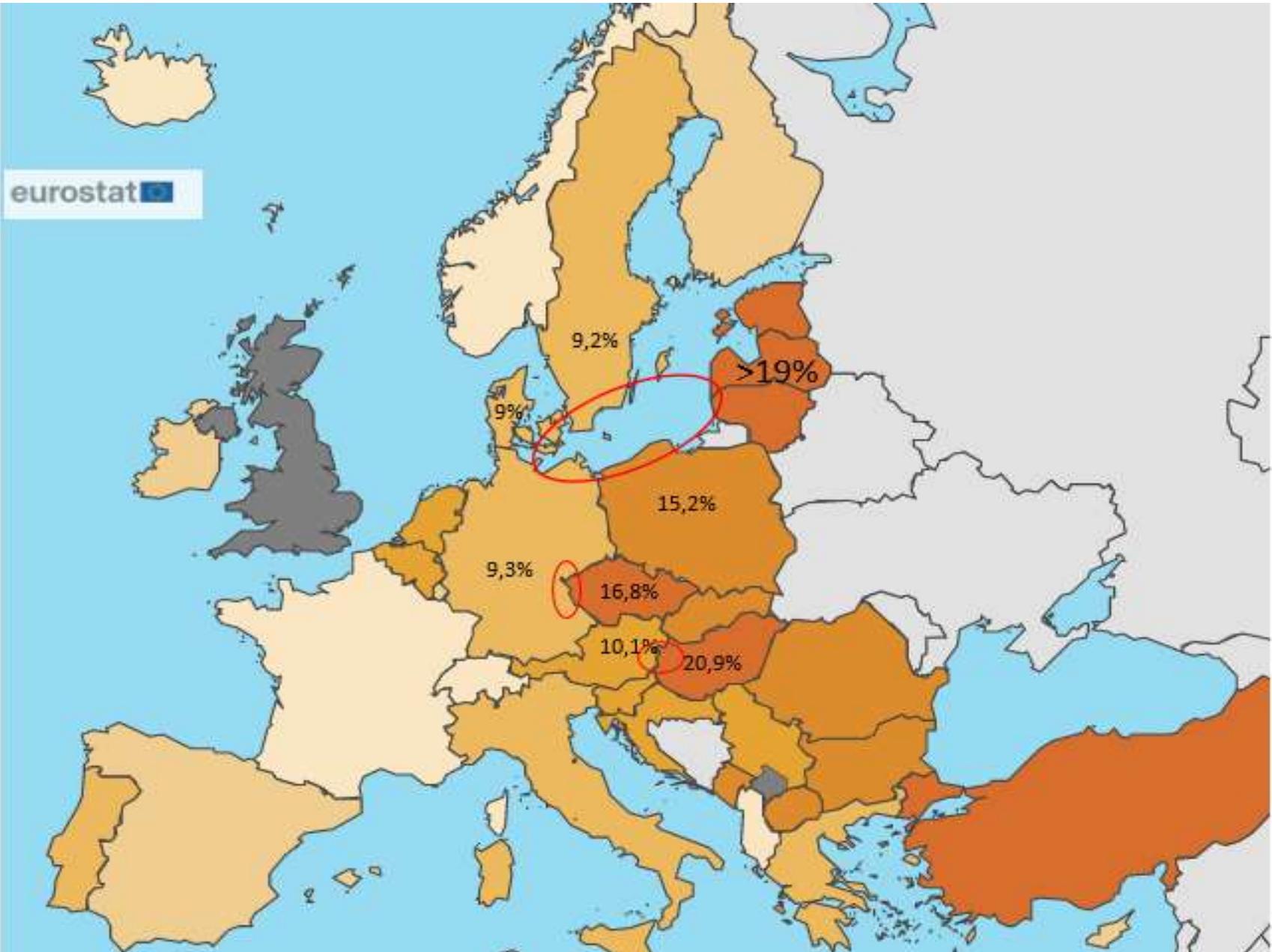
HICP- monthly



Inflation

HICP- monthly

April 2023



Main drivers

Bottlenecks

Shifts in labor supply (long-term health effects + shift workers' preferences toward teleworking). Post-pandemic supply (e.g. semiconductors), transport, delivery chains bottlenecks.

Reopening after the lockdowns

Consumers' preferences changes - limited households' ability to consume many services during lockdowns => shifted consumption toward goods => contributing to soaring commodity prices. People feel more relaxed after the pandemic – increased demand on several services – ‘the catch-up effect’ (e.g. holidays, restaurants); increase demand for some goods (e.g. for teleworking).

Pre-war restriction of energy supplies by Russia

Russia's invasion on Ukraine

Inflation is more sensitive to...

Changes in domestic (economic) slack

Economic slack is a phrase used to describe the amount of resources in the economy that are not used (in emerging European economies).

External price pressures

e.g. increased competition; manufacturers' delays; delivery chains disruptions; pressure from customers (in emerging European economies);

Commodity price shocks

Emerging economies and low income countries are more vulnerable to food price shocks; More Food prices pass-throughs; increase of prices predates pandemic;

Inflation has also become increasingly backward looking.



It is too early to judge whether these findings signal long-lasting shifts in the structural relationships underpinning the inflation process in Europe. Nevertheless, the suggestive signs are worrisome. The increase in the extent to which inflation is influenced by its past values could make it harder and costlier to reduce inflation from the multidecade highs that it reached in 2022

International Monetary Fund, Working
Paper 23/30 from February 2023

Inflation hurts

Programme targets

Some of the assumptions in the Methodology Paper may have to be adjusted

TA budget

All key elements have seen substantial price increase in past two years including labour force as key element

Macro-problem requiring micro-steps

E.g. quicker pace in indexation of SCOs, update of cost benchmarks; quicker adjustment when doing budget assessment etc.

Discussion: implications & options

Implications:

- **Tendering** – no offers received; repetition of tenders
- **Harm for projects with construction activities** - often hard to distinct if there was a bad planning / feasibility or if the problem is actually inflation-driven

Options:

- **Focus on ongoing projects** – downsize less important activities, maintain close monitoring, allowing for quicker and more flexible approach to changes
- **Programme specific SCOs** – do not forget about adjustment methods in your methodologies (It is possible to use different SCOs from one call to another)
- **Develop understanding for inflation impact among projects and programme bodies in critical sectors** – such as construction in order to avoid misleading responses to ‘inflated inflation stories’ and provide a better basis for more informed programme responses; based on shared understanding of the MC
- **Develop distinct procedure for infrastructure projects** – there are indications that problems peak in such projects since procurement is a key source of delayed project, also delivery needs to be factored in

Discussion: infrastructure projects

Challenge

- **Develop distinct procedure for infrastructure projects** – problems related to inflation peak in such projects since next to a sharp price increase for all production factors also procurement as a key source of delayed project delivery needs to be factored in; hence it might be beneficial to consider specific options for infrastructure projects – be it for the period from application to contracting and/or for the implementation period

Options

- **Contingency reserve** – the obvious challenge is to provide a clear frame that allows for fair and equal treatment regarding such requests: What elements can be downsized without major loss for the overall project? What is the clear explanation and justification for a price increase? When such budget will be available to a project? The conditions to make use of the contingency budget must be clearly set out in the contract and it might require construction expertise to safeguard fair and equal treatment. This approach requires improved financial management, because it might lead to delay in absorption of funds at programme level
- **Use of two-step procedure (project idea and full application)** – the eventual weakness - its longer duration - might be turned into a strength; upon acceptance of the initial idea and a rough budget estimate the time until submission of the project could be used to update / finetune the initial cost estimate and turn the concept into a mature project ready to start tendering immediately upon MC approval (a quick pathway from decision to contracting stage would be an important asset)

Problems at Programme level

- **Too extensive project assessment and pre-contracting procedures** – often these procedures involve several stages, requiring intermediate approval and other administrative delays. The time period between submission of project proposals and commencement of project implementation often is around 1 year, which is incompatible with current inflation rate fluctuations;
- **Lack of synchronization in calls' announcement and contracting** – opening of calls and commencement of project implementation is rarely synchronized in terms of season, time of the year. Etc. which leads to delays in starting of certain activities (construction, seasonal characteristics of target groups like students, tourists, etc.);
- **Unavailability of additional funds** – available programme funds are allocated per years and per priorities, with no additional funds as provision. All possible indexations of project's budget require availability of programme funds under the priority in question, and often require programme modification, which again is a time consuming and complicated procedure, requiring approval by the MC (partially alleviated in 2021-2027 with new regulations and simplification from the side of EC's approval);
- **Too complicated contract modification procedures** - changes in already approved projects are often too complicated and time consuming, and also often require approval by the MC;
- **Unpredictability of inflation**

Options at Programme level

- **Make it a case in the MC!** Important to foster shared understanding of all programme partners
- **Speeding up and simplification of assessment and pre-contracting procedures as well as contract modifications!**
Decreasing the number of step/stages and administrative interim controls;
- **Improvement of timing** of call announcement of commencement of project implementation – obviously connected to previous step!
- **Improved financial planning and simplification of Programme amendment procedures;**
- **Clear guidance for projects planning works!** Project maturity is in mutual interest!
- **Improved economic analysis before launching of calls;**
- **Ensuring good communication and partnership with project management teams.**

Problems at project level

- **Unavailability of additional funds** – often project partners envisage additional funds only for operative costs under the project, relying on fast absorption and verification. Financial provision is rarely planned; quite often projects underspend and almost never ensure full absorption of funds;
- **Extensive procurement procedures** – the deadlines for prior announcement of tenders (especially large scale ones) and the time necessary for assessment of bids in cases of supply and construction may exceed 9 months, which is incompatible with current inflation rate fluctuations;
- **Deficiencies in financial planning** – not always project partners dedicate sufficient time and resources on financial planning and budget preparation leading to unnecessary project expenditures, neglecting the actual market situation.

Quite obviously problems peak when it comes to investment projects including construction! (rise of almost all cost factors, short validity of offers, shortage of labour force, i.e. less interest in small works etc....)

Options at Programme level

- **Envisaging of provision for compensating the inflation**, including from external funding?
- **Support to procurement process** – better planning and execution of procurement procedures, ensuring more efficiency and better pace;
- **Improved financial planning** – dedicating sufficient time and resources on financial planning and budget preparation with applicants!
- **Ensuring good communication and partnership with programme bodies.**



Let's look forward. You predict that the inflation rate will go down rapidly from 10 per cent at the end of last year to 2.8 per cent at the end of this year and then further towards the inflation target of 2 per cent. Why you are so optimistic?

It's a mix of factors. Energy prices are falling. Food prices are still very high and that is what people see when they go to the supermarket. But if you look at the earlier stages of production, at the farm gate prices, at the prices of the food ingredients, you will recognise: all of these have turned around. And history tells us that this will eventually lead to lower retail prices. [...] our overall assessment is a rapid decline of inflation at the end of this year.

Interview with Philip R. Lane, Member of the Executive Board of the ECB, conducted on 22 March by Kolja Rudzio (Die Zeit)

Thank you for being here!

Your opinion matters to us.

Please take a few minutes to provide us with feedback to help us improve our services.

Log into the **Whova app**, go to the **relevant session**, and tell us what you think in the **session Q&A**.

You can also talk to us at the Conference Support stand in the networking area.



Cooperation works

All materials will be available on:

[Interact / Events / Interreg Knowledge Fair \(23-25 May 2023\)](#)