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The Dilemma of "Better Spending" in the EU Budget Negotiations: Austerity or Growth?

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In the first phase of negotiations on the new EU Multiannual Financial Framework (MFF), the bloc's net contributors used the notion of "better spending" to try to cap the common budget or even to cut it. The Friends of Cohesion, a group opposed to cuts in cohesion policy funding, saw its concerns about a decrease in the size of the budget take form when the Cypriot Presidency announced that a reduction was inevitable. By meeting the net contributors' demands to reduce the budget, though, this development eases the possibility to make new goal-oriented alliances among states on both sides of the divide on cohesion policy.

The MFF negotiations can so far be characterised as a struggle between two camps—the net payers and the net beneficiaries. The first group aims to minimise the amount of common funds in the budget, and in April 2012 renamed themselves the "Friends of Better Spending." Paradoxically, this rebranding might ease cooperation with the "Friends of Cohesion" (the net beneficiaries), whose aim is to preserve the significance of structural funds. After all, the eurozone sovereign debt crisis has not only forced the Member States to seek savings but also has revealed the decreasing competitiveness of certain members. Although the Member States are concerned with getting the most out of the budget, this re-branding creates space for a constructive debate on the budget, and in particular on structural funds as one of the measures that enhance the EU's global economic position.

From Austerity to Growth. Besides the political and social backlash against austerity policies, there are some negative economic consequences of massive belt tightening. First is the austerity paradox, which means that countries save money by cutting whatever is simple to slash, rather than by eliminating the least effective items. Second, concentrated savings in one short period may lead to a recession and to the deteriorating performance of firms (due to new taxes and new regulations as well as uncertainty around funding). The effect of such policies is to reinforce cyclical difficulties rather than alleviate them.

Moreover, if such policies were carried out EU-wide, it would distort the global economic balance, which is not convenient for either Member States or third countries. This is why criticism of the bloc's focus on savings has also come from outside the EU. At June's G20 summit, the EU agreed to "an emphasis on a growth-friendly composition of consolidation," an element that had not appeared in similar documents from previous summits. Also, in October, the IMF criticised the EU members for hampering growth. Of course, the biggest EU countries can withstand this political pressure, but changes in the internal and external political constellations have nevertheless had an impact on perceptions of the role of austerity in ending the crisis.

The Notion of Better Spending. On 26 April, the net contributors named themselves "Friends of Better Spending," indicating that their main goal would be to optimise common expenditures. However, their real objective remains the same—they aim primarily to reduce the overall budget on the basic assumption that smaller is better. Nevertheless, the "better spending" feature might prove to be a useful instrument for net beneficiaries as it needn't be understood solely as an excuse for cuts. Indeed, it may be used by these two groups to achieve a common objective—to quit the crisis by means of common funds. Hence, the basic question arises: Can "better spending," meaning an effort to use the budget to increase growth in a sustainable way, be applied to the MFF?

The notion of better spending includes many aspects of financial management, such as planning, the division of means and implementation, but in the current circumstances the key issue would have to be results oriented and answer the question of what impact spending will have. This issue is indeed beginning to emerge in the MFF debate. A relevant non-paper by Germany from August 2012 looks at the question of improving effectiveness by means of the use of macro-economic conditionality mechanisms as well as the robust supervision of structural funds. Certain budget items, however, are beyond the scope of the German paper. The Visegrad Four's non-paper from October addressed this problem and proposed to extend macroeconomic conditionality to the entire MFF.

Conclusions and Recommendations. There are two possible applications for "better spending" in the MFF. The first, proposed by the net contributors, is cuts in spending, which means covering EU activity with a smaller budget no matter the economic effect. This is, in fact, in progress. The second is to stress the economic impact of budget items. In this second version, the concept of "better spending" would support competitiveness and growth policies—a logical move. Of course, within the context of the MFF negotiations, it is not being right that counts, but rather the weight and unity of the coalitions supporting a given position. But since the desire of some Member States to limit the EU budget is now satisfied, additional pressure on assessing the economic potential of specific budget lines might exacerbate divisions within the net-payers club. This would enable the use of the "better spending" idea in the sense of improving effectiveness in order to start a fully-fledged "budget for growth" crusade with the blessing of both camps.

At this stage of the negotiations, of course, it is hard to redefine the political constellation. It is not, however, impossible. Even if a basic division between net payers and net beneficiaries remains, subsidiary groups containing members of opposite camps will begin to appear. A "Smart Growth Initiative" formed by Germany and the Nordic and Baltic states has already emerged, though it concentrates on many issues including national budgets. A "Friends of Growth" group, by contrast, would concentrate on maximising the economic potential of budgetary items, though no country has tried to start such a faction. There is thus an opportunity for Poland to propose it, gather members and thereby to set the agenda. Three possible agendas might form the basis of such a group.

The first would seek the extension of ex-ante, performance and macroeconomic conditionalities to cover all budget items, if their construction and general purpose allow it. These should be proposed because they include incentives to, on one hand, spend money in the most efficient way and achieve satisfactory results on the other. Poland has already proposed something similar in the V4 framework, however not as a basis for a new coalition. This might be proposed to countries that are interested in cutting the EU budget but indifferent to the items to be cut. Hence the possible coalition may include the UK and the Netherlands as well as the Nordic and Baltic states. The benefit for the EU would be a significant improvement in the total quality of common spending, whereas for Poland it would be in safeguarding the spending lines that matter most to it and, in the long term, see an increase in its exports due to improvements in the European economy.

The second possible basis for such a coalition is the decrease in direct payments under the Common Agricultural Policy, since this is a source of ineffective spending. Such a move would probably alienate Germany and France, but could again mobilise the Nordic and Baltic states. The V4 countries might encounter resistance from farm lobbies, though this is not impossible to overcome. This option is viable for Poland as the returns from cohesion policy and even rural development are greater than is direct aid to farmers. Also, national co-financing of these payments would be an interesting idea, provided legal and systemic uncertainties (linked for example with the Single Market or food safety) are solved.

The third option is trickier due to the limited horizon for negotiations, closed legislative packages and its relative novelty as an idea, but it is appealing in the context of tailoring the EU budget to competitiveness and growth. The idea would be to merge "Horizon 2020" with the Common Strategic Framework to create one larger competitiveness framework. It would be effective if it allowed greater flexibility and combined various financing sources to run specific growth-friendly projects. Also, one important thing would be to redefine the excellence criteria within research financing, which would allow for more of a level playing field.