

## Time for a debate on EU budget policies

Funding measures hinder innovation

by Miroslav Singer in Prague

Mon 12 Dec 2016

A serious problem is starting to stir in the heart of Europe. European Union funding for enterprises, designed to improve the innovative capacity of economies that only 25 years ago were run on centrally planned lines, is proving increasingly counterproductive.

Vojtěch Benda, a member of the Czech National Bank board, has summed up the issue with commendable directness. Examining a structural shift in financial management of Czech firms, Benda says, 'The more investment decisions of private companies become related to the EU funds absorption cycle, the less they are driven by their own innovation, entrepreneurial outlook, and evaluation of investment risks.'

The scale of EU-driven private investments is still relatively low. However, these flows of funds have risen greatly in recent years, and can now make a real economic difference. EU funds being channelled into central European enterprises are beginning to have consequences at the macroeconomic level, creating new challenges for central bankers.

The EU matters a great deal in the grand scheme of central European economic development. This is good news for pro-Europeans. The noble aim of these funds is to enhance development of central European economies by supporting efficient firms and activities. However, the way these schemes work in practice tends to subvert the original motivation. Funding flows to larger, rather than smaller, firms capable of covering transaction costs in traditional fields. To quote Benda again, 'Instead of making an investment in new productivity-enhancing technologies, they support another construct in which the existing technology is replicated.'

All Visegrad Group (Czech Republic, Slovakia, Poland and Hungary) central banks mention the EU absorption cycle as a factor in their latest quarterly report. Interest rates in central Europe remain relatively low and are unlikely to move up significantly any time soon. The EU funds budgeting procedure, by tending to produce a funding over-supply, is one of the factors behind this state of affairs.

Central European economies are effectively in a new macroeconomic cycle. This blunts the effectiveness of central banks' monetary tools. Official funding support appears to be geared towards private entities that are past the most innovative stage. This bypasses smaller more innovative companies. This is not an appropriate way to improve efficient allocation of resources in central Europe – or anywhere else. It is time for a proper debate on whether these measures help or hinder the European economy.

Miroslav Singer is former Governor of the Czech National Bank and a Member of the OMFIF Advisory Board. He lectures at CERGE-EI and the Prague School of Economics.