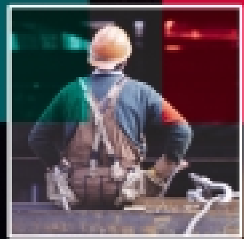
Parliamentary Group of the Party of European Socialists

European Parliament





PES Group seminar on

THE FUTURE of the STABILITY and GROWTH PACT

EUROPEAN INVESTMENT STRATEGY FOR MORE GROWTH AND EMPLOYMENT

Political summary

12 DECEMBER 2002

PROGRAMME

12/12/02, morning, from 10.00 am to 12.30 pm

Chair ➡ Robert GOEBBELS, Member of the European Parliament, PES Group Vice-President for Economic, Employment and Social Affairs and PES Coordinator for the Economic and Monetary Affairs Committee

Introduction: "A pro-active approach for more investment in Europe"

SPEAKER

- Mr. QUINN, former Finance Minister of Ireland, Dublin, Ireland

Panel ➡ ***MEMBERS***

- Mr. ROTH, Vice-President of the EIB, Luxembourg
- Mr. SCHUBERT, former Deputy Director-General of DG Finance and Economic Affairs, European Commission, Brussels, Belgium
- Mr. HORN, Head of Department of Macro Analysis and Forecasting of the "Deutsches Institut für Wirtschaftsforschung", Berlin, Germany
- Mr. SOUSA, Think tank "Notre Europe", Paris, France

Debate

12/12/02, afternoon, from 3.00 pm to 6.30 pm

Chair ➡ Bruno TRENTIN, Member of the European Parliament and Member of the Economic and Monetary Affairs Committee

Introduction: "New policy instruments to guarantee growth, stability and cohesion"

SPEAKER

- Mr. CHRISTODOULAKIS, Greek. Minister for the Economy and Finance, Greece

Panel ➡ ***MEMBERS***

- Mr. GABAGLIO, Secretary General of the ETUC, Brussels, Belgium
- Mr. KOTZ, Economist at the German National Bank, Frankfurt, Germany
- Mr. VACIAGO, Economist at the Catholic University of Milan, Italy

Debate

Conclusions: "European investment strategy for more growth and employment"

Chair ➡ Robert GOEBBELS, Member of the European Parliament, PES Group Vice-President for Economic, Employment and Social Affairs and PES Coordinator for the Economic and Monetary Affairs Committee

Stability plus growth - a political foreword

The Stability and Growth Pact (SGP) was agreed in the early 1990s in order to encourage the members of the Eurozone to introduce greater budgetary discipline. The main aim of the Pact, namely to reduce public debts and prevent permanent deficits in public budgets, deserves continued support. No individuals or states can afford to live beyond their means in the long term. If they have too many debts, this considerably narrows their room for manoeuvre. It is up to Socialists and Social Democrats in particular to stand up for stability and the fight against inflation. Inflation, i.e. losses of purchasing power, hits low-income groups very hard, precisely those to whom Socialists give priority and feel most committed.

This is why Socialists want a strong state, which intervenes in the economy to regulate and stimulate it. Especially in times of economic recession or looming depression, it is up to the state to promote growth. Yet the SGP says nothing about growth policy. A growth component therefore needs to be added to it.

In this respect, it would be welcome if the Pact were used more flexibly. One criticism of the SGP is that all states, regardless of their development and their situation, are measured by the same yardstick. The 'one size fits all' approach is not realistic. States whose debts amount to about 60% of GDP have more room for manoeuvre than those whose debts exceed 100% of GDP. Even temporary deficits in public budgets are acceptable if they are used for productive investment and to stimulate the economy in times of recession. The USA and the UK are currently taking this line. In the medium term, however, balanced budgets are necessary.

Yet the Union is having trouble with proposals to boost growth. The EU budget contains hardly any incentives for growth, given that it accounts for only 1% of the European national product. What is needed are new initiatives to stimulate infrastructure expenditure in the EU, especially in view of the forthcoming enlargement. It is high time to take up Jacques Delors' proposal dating from the early 1990s and to complete the unfinished trans-European networks by turning to the European Investment Bank or European loans. It is worth considering to what extent the profits of the system of European central banks could be used to finance this European infrastructure policy.

Stability policy remains necessary but is not an end in itself. To put it bluntly: a state, such as Salazar's Portugal, can have perfect budgetary stability and hardly any debts, while at the same time becoming poorer. Stability without growth cannot be the goal. It is only growth that can ensure stable conditions in the medium term.

Robert Goebbels
Vice-President of the PES Group in the European Parliament

Introduction

Alongside the Treaty provisions on Economic and Monetary Union (EMU), the Stability and Growth Pact (SGP) is the main EU economic policy instrument. Yet now, only three and a half years after the introduction of the euro, the Pact is facing testing times. In Germany, France, Italy and Portugal the overall public deficit has exceeded the ceiling of 3% of GDP. At the same time the Eurozone is facing its first serious economic downturn. There is increasingly strong criticism of and opposition to the SGP rules, which are regarded as too restrictive and unilateral. The demands range from a more flexible implementation of the Pact to its reform and even abolition. The SGP was created as a basis for financial solidarity and economic trust among Eurozone states. On the whole, it has proved its worth as an anchor of budgetary consolidation. The fact that this Pact is already being called into question shows how reluctant Member States now are to accept binding forms of economic and financial coordination in order to achieve sustained economic growth, higher employment and social cohesion in the EU.

Against this background, the PES Group organised a one-day seminar under the title: 'The future of the Stability and Growth Pact. A European investment strategy for more growth and employment'. The seminar was attended by various representatives of the different EU institutions, by economic experts from national banks, as well as by academics from different European networks in the field of economic and monetary affairs. Among the speakers and participants in the debates were the Commissioner for Economic and Monetary Affairs, *Pedro SOLBES*, the Commissioner for Employment and Social Affairs, *Anna DIAMANTOPOULOU*, the former Finance Minister of Ireland, *Ruairi QUINN*, the Vice-President of the European Investment Bank (EIB), *Wolfgang ROTH*, the former Director of the European Commission, DG Economic and Financial Affairs, *Ludwig SCHUBERT*, as well as the Secretary General of the European Trade Union Confederation (ETUC), *Emilio GABAGLIO*. PES Vice-President and PES Coordinator of the EP Committee on Economic and Monetary Affairs, MEP *Robert GOEBBELS*, chaired and summarised the discussions of the seminar and developed some political conclusions. As we will see in the following summary of this seminar, it could be possible to establish a proactive approach for more investment in Europe; a positive way to implement flexible policy instruments in order to guarantee sustainable growth, financial stability and social cohesion in the framework of the SGP.

The original idea: the **STABILITY** and **GROWTH PACT** as envisaged by EMU

Ruairi QUINN[1] began by noting that the current controversy about the SGP is certainly not new. The SGP was proposed and carried through by Theo Waigel, the then German Minister for Finance, but gave rise to dispute from the outset. Critics saw the SGP as a straitjacket. They felt it was directed too unilaterally at budgetary consolidation and therefore left little room for manoeuvre for a growth and employment policy. Supporters of the SGP, however, thought that repayment of the public debt was in fact a way to combat one of the causes of weak European growth. High public debts would be a burden on capital markets and on private investment activity because of higher interest rates. In their view, the way for financial policy to promote economic growth was not through high public deficits but by reducing the taxes, duties and transfer payments that acted as an obstacle to productivity. Budgets that were balanced in the medium term should make it possible to pursue a financial policy in line with the short-term economic situation.

'The political imperative of the SGP lay with the necessity to reassure German citizens that the "hard value" culture of the DM would inform the performance of the Euro,' was how *Ruairi QUINN* summarised the historical point of departure for the SGP. 'Once it was clear that EMU membership would extend beyond a core of DM zone countries, restraints on government finances became a political necessity.'

The SGP plays a central role in the political process of the Eurozone countries. Unlike the case of national currency zones, European economic and monetary union has no political authority responsible for economic policy. This responsibility remains with the Member States and is based merely on the 'common interest'. Member States are still seeking to preserve their national decision-making powers and margin for manoeuvre. Economic policy is coordinated on the basis of 'principles' adopted by the European Council. If a Member State does not comply with these principles, there is no means of making it do so, apart from a certain peer pressure.

The situation is different in regard to European financial policy, which is subject to multilateral surveillance and possible sanctions. There are reasons for this special situation, as emphasised by *Ruairi QUINN*: 'When the technical detail of SGP was originally negotiated, it sought to balance two important principles: in any economy it is important that fiscal policy and monetary policy should not work at cross-purposes. In the context of EMU, there was a clear risk that, with an independent European Central Bank (ECB) charged solely with maintaining price stability, failure to effectively coordinate the fiscal policies of the Member States would result in higher interest rates and lower growth. The Member States should support the stability policy of the ECB through their budgetary behaviour. This should help avoid conflicts in which the ECB, in accordance with its mandate, should combat the risks to stability resulting from excessive public deficits by means of a restrictive monetary policy. At the same time, it was important to maintain a certain fiscal autonomy of Member States, for both political and economic reasons. In drafting the SGP, and in its subsequent implementation, the members of ECOFIN (Council of Economic and Finance Ministers) have consistently preserved those principles.' All speakers of the seminar agreed that there are no academic justifications for the SGP; it is a political compromise.

The 3% of deficit criterion was introduced in order to make the existence of an excessive deficit measurable and bring it under the rules of budget surveillance. The aim of this criterion is to encourage the Member States to keep their public budgets 'close to balance or in surplus'[2] . Member States must present their updated stability programmes not later than early December each year. Together with the European Commission's autumn forecast, they form the basis for assessing the most recent budgetary trends in the Member States and in the EU. With the introduction of the euro, they are now all suffering the consequences of an unsound budgetary policy – rising interest rates and the loss of monetary confidence – especially when these appear in a large Eurozone country. In this respect, the SGP offers a mutual assurance that the individual Eurozone states will tackle their budgetary problems themselves rather than trying to fob them off onto the Community. During the process of budgetary consolidation, the small and medium-sized EU states have proved particularly successful here. In the economic boom years 1999/2000 most of them achieved balanced budgets or budget surpluses.

If the European Commission decides that a Member State has an excessive deficit, it informs the Ecofin Council thereof and makes a recommendation on budgetary consolidation. The Ecofin Council, acting by qualified majority, takes the final decision on whether the deficit is excessive. This procedure can be suspended temporarily if the country in question takes the appropriate adjustment measures. If the Member State does not comply with the recommendations, the Council can decide to impose sanctions, in the form of an interest-free capital contribution. The amount is based on the percentage points by which the deficit exceeds the 3% of deficit margin and on the GDP. If the deficit is not made up within two years after the decision on sanctions, the Council may decide to turn the contribution into a monetary fine. However, thanks to the annual updating and continuous monitoring of Member States' stability programmes, the Member State in question is not suddenly faced with an excessive deficit or even sanctions.

1. Ruairi QUINN is a former leader of the Irish Labour Party. As Minister for Finance 1994-1997, and Chairman of the ECOFIN Council during the 1996 EU Irish Presidency, he played a leading role in the negotiation of the SGP.

2. The EC Treaty requirements were complemented by the SGP consisting of two Council Regulations 1466/97 and 1467/97 and solemn political commitments enshrined in a resolution of the 1997 Amsterdam European Council, OJ L 209 of 2.8.1997 and OJ C 236 of 2.8.1999.

The European Commission's **CURRENT INITIATIVES**

In January 2002 the European Commission recommended to the ECOFIN Council for the first time that it should apply the early-warning instrument to two Member States, Germany and Portugal. In order to avoid receiving a 'blue paper' from Brussels, the German Government undertook to adhere to the 3% of deficit margin and to take the appropriate measures to achieve the target of a more or less balanced national budget by the year 2004. At its meeting of 12 February 2002, the Ecofin Council took note of this undertaking and decided not to issue Germany with an early warning. The same procedure was then applied to Portugal.

In November 2002, however, the European Commission expected Germany to show a public deficit of 3.8% of GDP for 2002 and 3.1% for 2003. On 21 January 2004 the ECOFIN Council decided that Germany had exceeded the ceiling of the national deficit and introduced the budgetary deficit procedure in accordance with Articles 104 ff EC Treaty. The forecasts for France were similarly bleak, with a rise to 2.8% of GDP in 2002 and a projected 2.9% of GDP for 2003. Accordingly, on 21 January 2003 the Council decided to apply the early-warning system to France. Portugal's public deficit reached 4.1% of GDP in 2001. Although this public deficit eventually fell to 2.5% of GDP in 2002, at the end of that year the Commission also called for the early-warning instrument to be introduced for Portugal, in order to keep the public deficit for 2003 below 3%. In the end, Italy's public debt 2002 rose to more than 100% of GDP. This meant the budgetary position of four large Member States had now worsened in the space of a few months and constant corrections to the actual and expected public deficit led to increasingly bitter discussions about increasing the flexibility of the SGP.

The time frames for the medium-term balancing of the budgets have now become more flexible. Under the Broad Economic Policy Guidelines for 1999 of 12 July 1999, Member States had to endeavour more or less to balance their budgets by the year 2002. In its Broad Economic Policy Guidelines for 2002 the European Council recommended that states which had not yet achieved this budgetary target should do so by 2004[3]. Meanwhile, following a European Commission proposal of 25 September 2002, the target date was postponed more or less officially to 2006[4]. In view of the overstretched public budgets of the four problem countries, the Commission proposed, at an informal Eurogroup meeting early in October 2002, that these four countries should reduce their cyclically adjusted budgets by at least 0.5% of GDP per annum as from 2003 to 2006. The accompanying general agreement that the target date for balanced budgets would be deferred from 2004 to 2006 met with huge resistance from Eurozone states that have already consolidated their budgets.

*3. Broad Economic Policy Guidelines 1999 and 2002:
http://europa.eu.int/comm/economy_finance/publications/european_economy/1999/ee_gopeannex1999_en.pdf and
http://europa.eu.int/comm/economy_finance/publications/european_economy/2002/ee402en.pdf*
4. Communication of Commissioner Solbes in agreement with President Prodi: Budgetary challenges in the euro zone, SEC (2002) 1009/6, 25 September 2002.

The proposal to reduce the cyclically adjusted structural deficit by a certain percentage every year introduces a new assessment instrument, which was endorsed by all participants in the seminar. It follows on directly from the aim of the SGP to balance the budget in the medium term, i.e. given a normal economic situation, so that it can have an anti-cyclical effect on the economic trend. The European Commission is seeking a uniform method of calculating the structural deficit, which will also and in particular evaluate the sustainability of budgetary consolidation. This proposal also resolves another problem, which arose with the way the SGP was originally applied. Normally, the SGP comes into play only where an excessive deficit already exists. If the budget was not adequately consolidated in a time of economic upturn – as is the case in the problem countries – the only way they can change this situation is by continuing to economise in times of recession, i.e. by pro-cyclical behaviour. To prevent this effect, budgetary consolidation should be pushed through during periods of economic upturn. However, the SGP has no effective means of achieving this. If, however, the structural deficit is subjected to budgetary surveillance, it is possible not only to determine whether the buffer zone is wide enough to keep the nominal public deficits below 3% of GDP during economic downturns, but also to monitor more closely whether the Member States are behaving anti-cyclically during economic upturns and forming the appropriate surpluses. The structural budget, adjusted to correct any cyclical influence, should always be balanced.

The participants in the seminar agreed that the postponement to 2006 does not conflict directly with the SGP but does weaken confidence in jointly reached agreements. That makes it most important to remove any further difficulties and non-binding provisions in the implementation of the SGP and at the same time to strengthen economic and financial coordination.

The debate on the coordination of budgetary policies within EMU and the implementation of the SGP 'in no way justifies calls for radical review of the EU's budgetary rules', underlined Commissioner *Pedro SOLBES*[5] during a working lunch of the seminar. He did not fully share the present criticism of the Pact. In his view, 'on the whole, the Pact provides an appropriate framework for cautious budgetary management which is in the economic interest of each country. Respect for budgetary discipline obligations agreed in the Treaty and the Pact is essential for the correct functioning of the EMU, and especially for single monetary policy.'

According to *Pedro SOLBES*, the worsening of the budgetary situation over recent years can only be partially attributed to the impact of the economic situation. In the current environment of mediocre growth and the worsening budgetary situation, there are a number of difficulties in implementing the SGP, he recalled. These are:

5. Commissioner Pedro SOLBES became Member of the European Commission in September 1999, responsible for economic and monetary affairs. http://europa.eu.int/comm/commissioners/solbes/index_en.htm

- Member States are becoming less politically involved in favour of implementing the Pact. Although most Member States continue to sign up to the Pact's objectives, the gap is growing in some countries between their budgetary commitments and the concrete measures taken to achieve the stated objectives. Some have refused to recognise the effect EMU has on conducting budgetary policy at national level.

- It has proved difficult to define clear and verifiable budgetary objectives that take underlying economic conditions into account. In assessing compliance with budgetary commitments, account should be taken of the impact of the economic situation and of other transitional effects. This is essential to avoid pro-cyclical policies in periods of sustained growth.

- Pact application procedures have proved to be inadequate at critical moments. This is mainly the case of the early-warning mechanism, which has not been used sufficiently early to allow the countries concerned to take correcting measures before their deficit comes dangerously close to 3%.

- Greater emphasis should be placed on viability and quality. The framework of the Pact contains elements allowing for greater account to be taken of the differences in terms of quality and viability in the management of public finance, but this potential must be used more systematically.

In order to tackle these difficulties in implementing the Pact, the European Commission adopted, on 27 November 2002, a communication setting out proposals aimed at strengthening the coordination of budgetary policies in the EMU[6]. This communication does not propose either to modify or to ease the budgetary provisions of the EC Treaty and the rules of the Pact, or to introduce new mechanisms in the budgetary surveillance procedures. The communication, approved by the European Council in March 2003, presents five proposals defining guidelines that the Commission and the Council may use as a basis when implementing the Pact. These five proposals are:

- Reduction of public debt: Countries with high debt levels well above the 60% of GDP would be required to set down ambitious long-term debt reduction strategies. Failure to achieve a 'satisfactory pace' of debt reduction should result in the activation of the debt criterion of the excessive deficit procedure.

- More flexibility to 'virtuous' countries: Member States where debt levels are well below the 60% of GDP reference value, and with budgets less than 3% could benefit from a certain safety margin for implementing structural reforms that conform to the Lisbon objectives. A small temporary deviation from the 'close to budget or surplus' could be allowed for tax reform or long-term public investment in infrastructure or human resources. The commission will, nevertheless, have to ensure a 'clear and realistic' deadline for the return to budgetary balance. Member States where debt levels are well below the 60% of GDP will have a longer period for this margin to operate but only after the Commission has robustly examined the outstanding public debt, contingent liabilities (and other costs associated with ageing populations).

- Objectives adapted to economic conjuncture: the Commission wants Member States to set themselves realistic perspectives of economic growth when they present their stability programmes. Budgetary surplus will be measured in relation to conjunctural variations.

6. COM (2002) 668 final, 27.11.2002. http://europa.eu.int/comm/economy_finance/publications/sgp/com2002668_en.htm

- Annual debt reduction: Member States whose budgets have not reached balance or surplus will be expected to commit themselves to reducing their deficits (adapted to conjunctural data) to less than 5% of GDP each year. This level will be higher for countries whose deficits or debts are higher, as well as for periods of economic growth.

- Discipline in periods of growth: the Commission wants to take advantage of the benefits of economic growth for establishing margins that are sufficient in times of economic slowdown. It believes that any relaxation of budgetary policy in favourable periods could trigger off a rapid reaction, according to instruments included in the EC Treaty.

The participants in the seminar were convinced that these proposals could strengthen the Pact's economic base while ensuring stricter and more coherent decisions at EU level and reaffirming the political commitment of the Member States to apply the Pact. This issue would be very important to the objective of restoring the economic credibility of the EU that has really been put to the test over recent months. However, it will still be essential for the Heads of State and Government to make the necessary political commitments to ensure more investment for more growth in Europe.

The **FUTURE** of the Stability and Growth Pact and **the Lisbon strategy – SELECTED ECONOMIC EXPERTS** speak

Former Deputy Director-General of the Directorate General for Economics and Finance at the European Commission, *Ludwig SCHUBERT*, introduced the discussion with the general question: 'Which economic policy?' Notwithstanding an apparent consensus on the economic policy approach, the Community has, in various regards, major problems with the planning, transparency and implementation of economic policy, which are aggravated by the institutional gaps introduced by the Maastricht Treaty. The problems are particularly apparent in relation to the results of economic policy: the success in achieving price stability and monetary union contrasts with the chronic inadequacy of the Community's results in terms of growth and employment. How can these problems be characterised ?

Furthermore, *Ludwig SCHUBERT* put some examples on the table for further discussion:
- insufficient public and academic debate;
- ill-founded dialectic between 'greater flexibility' and sound macro-economic management;
- the full employment objective is often not taken seriously;
- the question of how to make the interaction between monetary and budgetary policies and wage trends as favourable as possible to growth and employment, within the framework of EMU stability, is scarcely tackled at all or remains taboo;
- the economic policy guidelines are often adopted in a manner that is not transparent;
- the subsidiarity principle is applied in an asymmetrical manner, the concept of the common interest is not taken adequately into consideration;
- from the institutional and procedural point of view, the Maastricht Treaty is a step backwards in economic policy compared with the earlier situation following the Werner Plan.

Against this background, economist *Hugo SOUSA*[7] underlined that the SGP has some inefficiencies which have led to some inconsistency in economic policy management in the Euroland but that should not imply that the pact serves no purpose. Indeed, it is essential to have a rule for the coordination and mutual surveillance of budgetary policies in the EMU. Moreover, various studies point to the excessive burden that will be imposed on public spending from 2015 onwards, due to population ageing, which makes this one of the most important issues for the future. These studies point to an increase of between 4%-8% in public spending just to finance pensions due to population ageing. It is therefore essential that countries pursue sound fiscal and budgetary policies in the years to come, which imply expansionary policies during economic downturns and restrictive policies during an economic boom period. Hence, balanced budgets in the medium term are essential. Moreover, one of the purposes of the SGP was to avoid any policy conflict between monetary and fiscal policies. It aimed to prevent countries from running higher than desirable budget deficits, which they might be tempted to do in a monetary union as the effects resulting from such a deficit would spread around the entire EMU,

7. Hugo SOUSA, think tank 'Notre Europe', Paris, under the Presidency of Jacques Delors: http://www.notre-europe.asso.fr

thereby diluting its negative effects in the home country. Furthermore, it was meant to ensure some economic policy coordination, and together with the broad economic policy guidelines provides the main instrument for economic policy coordination in the EMU.

Therefore, in the view of *Hugo SOUSA*, no doubts should subsist today regarding the need to have a balanced budget and henceforth fiscal sustainability over the long run within a monetary union. However, the Pact always left open to countries the way to achieve the budget balance objective. It never distinguished between investment and consumption and moreover it never made a difference between good and bad spending. Another criticism often made is its lack of flexibility whenever the business cycle changes. So a country can theoretically be penalised if it breaks the 3% deficit ceiling, both if it failed to cut current expenditure and if it became a victim of a hostile economic atmosphere implying a loss in revenues. It can obviously be argued that countries should make the necessary expenditure cuts during economic booms so that they might be better prepared to deal with a possible economic recession once the business cycle changes. Nevertheless, the SGP clearly does not take into account this argument, as it fails to present binding rules for the pursuing of anti-cyclical policies. Therefore, clarification of the mechanisms underlying the Pact is urgently needed. In fact, the current difficult economic situation that the EU is facing provides the exact momentum to reflect further on this topic and to bring about a solution that would ensure better short-term and long-term coordination of budgetary policy in the Eurozone. Indeed, the current SGP is linked to monetary policy targets, neglecting some important aspects of demand-side economics such as investment. More coordination in employment policies, research and development investment and life-long learning is essential if the EU is to reach the Lisbon targets. The bottom line is that deficits should not be cut at the expense of public investment, although its components should be clearly defined.

In this context, economist *Giacomo VACIAGO*[8] added: 'When many countries share the same problem, a cooperative (positive-sum) game is required. Just avoiding negative spillovers (externalities) is not really enough to make a EMU successful. Every country should be expected to implement policies that have positive effects both for itself and for the others. In this sense, *Giacomo VACIAGO* recalled the fact that the SGP was renamed 'stability and growth': nowadays growth has to be deserved by implementing the appropriate reforms!'

Finally, *Gustav A. HORN*[9] drew the conclusion from all this that a fundamental reform of the SGP is necessary. In doing so, he said, one should benefit from the experience of the US government during the eighties and early nineties. First of all the question has to be answered whether any constraint on the euro area level is really needed. This is equivalent to the question whether there are externalities of excessive national deficits in the EMU. To be clear, in the light of the above arguments the case is not a very strong one. There are good reasons, such as preserving fiscal flexibility in the event of adverse shocks to avoid excessive deficits and a too heavy debt burden. However, these reasons are not built on external effects against the EMU but on purely national interests and would not require any rules at European level. The only case where such rules may have a positive effect is in times of high growth. In contrast to what present settings suggest, deficits should not be contained when growth is slack. They are rather a problem when the economy is working at capacity level. Then they may contribute to an overheating and cause inflation. Such spending behaviour may also be the origin of a potential default of a national government much later on. In any case existing deficits should be reduced with tailwinds of strong business activity. A very important point also applied in the US is that

8. Prof. Giacomo VACIAGO, Catholic University Milan, Department of Economics and Finance: http://www.unicatt.it
9. Prof. Gustav A. HORN, German Institute for Economic Research Berlin (DIW), Department of Macro-Analysis and Forecasting: http://www.diw.de

investment spending should be exempted from deficit calculations. By investment the production potential is increased and thus higher future revenues made possible.

Therefore, *Gustav A. HORN* continued, there is no economic problem involved with a deficit only caused by investment spending since it will prove to be only of a temporary nature. The only difficulty is what kind of expenditure should be counted as investment. In any case this can only be expenditure which promises higher future growth. The time span until the deficit target is reached depends on several factors. If the share of non-cyclical expenditure is relatively low (high) it takes longer (shorter). This should be considered when putting different kinds of expenditures into categories. It may be a matter of discussion into which category a certain kind of expenditure – cyclical, non-cyclical, investment – should be put. In order to make decisions in this respect comparable at European level, a team of academic advisers to the European Commission or to Eurostat should check whether all countries have applied similar and reasonable criteria. In any case, any reform of the SGP has to be made as a consensus, not only among Member State governments. It is of utmost importance in this context that the ECB also agrees with the changed method.

‘Public-Private-Partnership’ - an innovative instrument for INVESTMENT FINANCING

All participants in the seminar agreed on the need to encourage investment that boosts our economy’s productivity, such as investment in education and research, as also in transport infrastructure. Capital should be invested as efficiently and productively as possible in order to stimulate economic growth on a sustained basis. That means, as *Wolfgang ROTH*[10] put it from the point of view of the European Investment Bank (EIB) that ‘priorities must be set in regard to the type of investment, but at the same time more investment is needed overall, both private and public.’

Participants in the seminar also agreed, however, that macro-economic investment incentives are no longer possible or effective except within a narrow framework. If higher growth is to be achieved in the long term, there is therefore no alternative to micro-economic reforms to boost investment. In the EIB’s view, the key to this is public-private partnership (PPP) for infrastructure investment.

PPP can be applied when the public authorities feel obliged not to privatise a specific service yet hand over the infrastructure planning, construction, routine operation and maintenance to the private sector and leave the investment financing to the banks. Within this framework, the public authorities pay the private planners, builders, operators and financiers fees for the use of the infrastructure in question. This is possible and in some cases already the practice for the use of school buildings, hospitals, prisons, road tunnels, bridges, motorways and airports, as also railway lines. The public authorities can pay the fees for use annually out of tax money and/or also charge fees to the individual user.

Wolfgang ROTH emphasised that the purpose of PPP models was not to open up new sources of financing but rather to save costs in the planning, construction and operation, as also the financing, of infrastructure investment. Experiences in the UK, the Netherlands, Spain and Portugal have shown that savings in the order of 10% to 20% can be achieved, compared with the costs of infrastructure produced and operated by the public authorities. The EIB can confirm these experiences now that it has co-financed 40 PPP projects accounting for an overall volume of EUR 8 000 million in the EU.

The use of PPP models inevitably also means that investment projects are evaluated more accurately and that the various options are weighed up, because the investment, operating and maintenance costs of a project throughout its life span are included. The public budgets and the provisions of various Member States do not necessary require this kind of complete costing of an infrastructure project. That means capital can be used more efficiently and transparently.

Wolfgang ROTH summarises the idea behind PPP as follows: ‘private savings capital flows directly into infrastructure financing – without the detour via the public budgets – while at the same time the management experience of the private sector is drawn on for planning, building and operating the infrastructure. PPP models take the burden off the public investment budgets and thus open up margins for manoeuvre for greater private and public investment. Here the EIB regards itself as in important partner in stepping up the use of PPP models in all Member States and thereby contributing to greater investment in Europe and more flexible use of the SGP.

10. Wolfgang ROTH, Vice-President of the European Investment Bank (EIB), with its headquarters in Luxembourg: http://www.eib.org.

A **broader** and **more realistic** 'Pact' - the position of the **ETUC**

Coming on top of ever more depressing economic and employment forecasts for the year 2003, the ETUC[11] called on the spring 2003 European Council to address the impending economic emergency and to give the starting signal for a reform of the SGP.

To face the many challenges of the next few years – of enlargement, ageing, exclusion, restructuring and competitiveness – it is vital that there is a recovery of the EU economy as early as possible. Not only medium-term oriented, but short-term initiatives in the field of investments and structural reforms are of high importance.

The EU's experience has been that if consumers and entrepreneurs lack economic confidence then existing, let alone new, potential will not be used. And the EU has traditionally depended on external demand to generate recovery, but with the US and much of the world economy now also in difficulty this can no longer, and should no longer, be relied on.

In the future, therefore, the ETUC believes that the EU must rely on its own efforts. Collectively, Member States do have room for manoeuvre to support the level of demand, and this must be fully utilised. The SGP should be interpreted intelligently now, and the European Commission's November 2002 proposals provide the basis for this. The responsibilities of budgetary policy for promoting recovery, and for saving the Lisbon strategy, will be eased if the ECB not soon reduces interest rates again, but if this is not the case then, with so much at stake, the budgetary authorities must act alone, coherently and consequentially.

However, the ETUC believes that apart from these ad hoc approaches being used, it is necessary to address directly the 'economic governance deficit'. An integrated European economy requires sophisticated management on the economic as well as the monetary side. The ETUC applauds in this context the efforts of the European Commission to get a real debate on economic coordination underway. In the view of the ETUC, the EU and the Eurozone need a reformed 'instrument' dealing with short term or conjunctural coordination since the BEPG are now the EU's medium-term, economic and structural policy mechanism.

Unfortunately, and despite the name of the SGP, is has been so far a stability rather than also a growth mechanism – and a rather rigid one at that. Because of this, the ETUC has always been critical of the Pact – and the 'chickens are now coming home to roost'. As a firm believer in the need to develop positive coordination mechanisms, the European Council should build a new consensus for a broader and more realistic Pact. This could well incorporate the 'golden rule' exempting investment expenditure from deficit definitions, and in any event give greater attention to debt rather than just deficit situations. Public policy now must be to promote investment, public as well as private, and – in line with the Lisbon strategy – in social and environmental as well as economic infrastructures.

11. European Trade Union Confederation (ETUC), established in 1973 to provide a trade union counterbalance to the economic forces of European integration. At present, the ETUC has in its membership 78 National Trade Union Confederations from a total of 34 European countries, as well as 11 European industry federations, making a total of 60 million members: http://www.etuc.org

Political CONCLUSIONS and proposals for REFORM

The serious downward economic trend is undermining the confidence of European businesses and of our citizens and requires therefore even stronger and more efficient efforts to implement the SGP in a more intelligent and flexible way. At the same time, the Pact's stability goal must be preserved. The rules should remain manageable and comprehensible and the 3% deficit of GDP criterion for excessive deficits be retained. This is the only way to put the emergency brakes on if earlier recommendations and peer pressure have not worked.

However, the promotion of public and private investment is urgent. In line with the stability goal, the creation of public-private partnerships operating in such areas as education and training, life-long learning, research, environmentally-friendly production, information and frontier technologies, telecommunications, energy and transportation networks would be highly desirable. In addition, special emphasis should be put on government investment expenditure with possible synergies among national and Community-wide public and private investment efforts, as well as on ways and means of stimulating a common investment policy in the EU.

Reforms are needed, however, to ensure that the SGP can be used as an instrument of more and stable growth and employment. The Commission has already taken an important step by allowing the structural deficit to be taken into account, instead of the nominal one. However, the reform of the SGP should include other variables, such as a better definition of public spending, namely a distinction between investment expenditure, current expenditure and revenue, what should be attained in the short and the long term, national debt levels, the use of anti-cyclical policies and clear binding rules for growth policy, supervised by a more active European Commission. Moreover, the Pact should be an active economic policy coordination mechanism and should move alongside the Lisbon objectives.

In view of the paradoxical fact that the Member States already fix their national stability programmes before the entire European economic policy coordination is put in place, it would be of high importance to introduce into the SGP more coherence and logic in line with the economic and employment streamlining process by making the national stability programmes an integrated part of the European economic coordination process.

Moreover, the deficit criteria should be evaluated according to their structural and investment components and the 'golden rule' related to investments should apply (i.e. that a distinction be made between current and capital spending). Since public investment increases the growth capacity of the economy, part of the cost can be safely spread over a longer period through deficit financing, without adversely affecting the sustainability of public finances. With a multiannual approach to budgeting for capital needs, there is no reason why the scale of this capital investment cannot be taken into account by the European Commission in its SGP monitoring role. That could help to provide for a growth and investment oriented SGP and to make it a more effective mechanism of economic policy coordination as well as a tool along with the Lisbon strategy. Because it is very important that the SGP acts in a supportive way in the attainment of the Lisbon goals rather than as a handicap.

Finally, the proposal to give further power to the European Commission, namely in initiating the early-warning system, should be considered. But something more effective would be to reverse the actual mechanism. Hence, instead of having the Commission recommendation approved by qualified majority vote (QMV) by the ECOFIN Council, the Commission recommendation would automatically come into force if the Council would not reject them; also by QMV. These proposals to strengthen the Commission's position in coordinating economic policy and in multilateral budgetary surveillance are consistent with the institutional logic of the EC Treaty and a precondition for the successful and proactive economic and financial coordination that is sought in the EU.

Besides the political conclusions already mentioned above, other suggestions for a reform of the SGP put forward during the seminar include:

- to set constraints for times of high economic growth;
- to introduce, for growth forecasts and growth-promoting activities, indicators of productivity levels, investment dynamics, stock rebuilding, and the evolution of demand and consumption;
- to set up a clear method for assessing the quality of public budgetary positions and their contribution to growth and investment;
- to let non-cyclical expenditure grow by less than nominal GDP;
- to let cyclical impacts work;
- to focus on a compromise between short- and long-term objectives which would imply attaining a budget balance across the European countries in the medium term, but over the long term to focus more on the debt level;
- to set up clear and binding rules (including sanctions) governing both the deficit value, the use of pro-cyclical policies and the debt value;
- to work towards a more explicit definition of 'European' public spending, i.e. what is done by each country but is of benefit at European level and for every EU Member State (e.g. transportation, research, education, etc.);
- to upgrade (for the time being only in a virtual sense) those items of public spending to European level, thereby avoiding the present mistake of referring to Europe only for more unpopular budgetary decisions.
- The appropriate strategy should be to reform the Pact so that it favours progress towards European integration.

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DEL PARTIDO SOCIALISTA
EUROPEO

EUROPEAN PARLIAMENT

RUE WIERTZ - B-1047 BRUSSELS
TEL.:+32 2 284 21 11
TEL. STRASBOURG: +33 3 88 17 40 01
INTERNET: www.socialistgroup.org

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