



POSITION PAPER

A GROWTH AND EMPLOYMENT STRATEGY FOR EUROPE

*OUT OF THE CRISIS - A BETTER
ECONOMIC MODEL FOR EUROPE*

*Jobs and growth instead of austerity and
recession*

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INTRODUCTION

The crisis which started in 2007 forced both Europe's member states and the US to use their fiscal policies in the attempt to prevent a long-lasting recession, or even depression. The US policies have proven more effective, because they were faster, stronger and longer-lasting. By contrast, the right-wing in the European Commission and Council consistently lagged behind events. Europe's fiscal stimulus was too little, too late and by 2009 - ignoring the lessons of history, driven by a fear of the financial markets and a misreading of macro-economics - the EU switched dramatically from economic stimulus to austerity, deepening and prolonging the economic and social crisis, in a self-defeating attempt to reduce public deficits and debt at an unattainable speed.

A more intelligent economic policy must start with an understanding of what went wrong. That is why our alternative strategy has three fundamental aims:

1. to achieve a smart fiscal consolidation, which restores confidence, takes full account of the economic situation, taps new revenues, protects essential investment and looks for savings in those areas of the budget which cause least damage to aggregate demand and inflict least social pain;
2. within a medium - term fiscal consolidation strategy, to implement a coordinated European Investment Strategy, focussed on modernising infrastructure, investing in human capital and laying the foundations for a smarter, greener Europe
3. to address the problems which caused the crisis, such as regional divergences in productivity, and a growing imbalance between wages and profits, which led to excessive dependence on credit to maintain aggregate demand.

1 REDUCING PUBLIC DEFICITS WITHIN A REALISTIC TIMETABLE

European rules require member states to cut their public deficits back to below 3% as soon as possible, and to aim for balanced budgets in the medium term. However, the new threat of a European-wide recession with global repercussions must be taken very seriously. Therefore, the European Commission and the Council must make use of the existing room for manoeuvre in the Stability Pact with regard to the economic cycle. This should lead to a better timed consolidation overall and to new growth inputs from

member states which still retain some budgetary room for manoeuvre, in order to avoid an additional contraction of internal demand across Europe and the Eurozone.

2 SAFEGUARDING INVESTMENT THROUGH SMARTER FISCAL RULES

The Stability and Growth Pact has contributed to falling public investment in Europe through its failure to distinguish between current and investment expenditure. Just like businesses, it makes sense for governments to borrow to finance productive investment - as long as the returns exceed the costs. Official statistics on public investment clearly show the negative impact of this design flaw: public investment across Europe is down from over 3.5% in the late 1990s to only 2.5% now.

New rules on public investment must be carefully drawn, to ensure they do not undermine fiscal stability. They should be defined in a "growth regulation" which would complement the existing rules on economic governance. On the basis of tightly drawn definitions of productive investment, monitored by the European Commission and using the national accounts definitions for which the Commission is already responsible, this regulation would introduce into the Stability and Growth Pact a distinction between current expenditure and investment, focussing the excessive deficit procedure on current public expenditure - that is, expenditure net of productive investment. The impact of this change, which would align the Stability and Growth Pact more closely with standard economic definitions, would be to create additional fiscal space in the Eurozone for a boost to investment. Building on the new treatment of investment, the regulation would lay the basis for a coordinated European Investment Strategy, which should focus on education, training, modernising infrastructure and developing smart, green and energy-saving technologies. The proposal is developed in greater detail in the annex to this note: *The missing link between stability and growth*.

3 DEEPENING THE ROLE OF THE ECB

As the crisis has revealed, the role of the ECB can become critical in purchasing government bonds on the secondary market in certain economic and market conditions. With new, tough European legal rules on public debt and deficits now in place, such intervention will in future take place within a properly rules-based context. ECB practice in this regard has undergone an ad hoc evolution in response to the

financial crisis. An important signal could and should now be sent to the markets through a clear statement by the ECB regarding its policy and practice in this regard. By standing formally ready to buy government bonds when appropriate in the light of economic and market conditions, the ECB would contribute further to achieving financial and economic stability, as well as lower bond interest rates.

4 TAPPING NEW REVENUES

A European FTT, which is strongly supported by the European Parliament, would raise at least €80 billion a year (and potentially more than €200 billion a year), a big contribution to fiscal consolidation. Tax fraud, evasion and avoidance cost EU governments €1 trillion a year. We have proposed a target of halving that figure by 2020 and have set out a series of measures, at EU and national level, to achieve it. We call on the EU to define an operational and ambitious action plan by the end of 2012, with the objective of meeting the 2020 target.

5 EU BUDGET

The EU's budget is an important instrument to boost growth and investment without adding to public debt. The new multi-annual financial framework (MFF) for 2014-2020 should be based on a minimum 5% increase of the 2013 ceiling, representing an average level of expenditure equivalent to 1.11% of GDP, and therefore remaining below the ceiling which has applied since 1992 (1.29% of GNI for commitments and 1.23% of GNI for payments). Structural Funds should remain at least at current levels and be combined with new financial instruments to support local, national and European projects to generate growth. Structural funds must remain accessible to all EU regions, while taking better account of the specific situation of countries in difficulties, through reduced or zero co-financing requirements. A substantial part (at least 25%) of the funds should be earmarked for social purposes and the fight against poverty. Infrastructure development in transport, energy, research, innovation, space research and green technologies must also be supported by the Structural Funds and by appropriate European instruments.

Part of our investment strategy must consist of having adequate EU-level resources and instruments to make EU solidarity more than a political proclamation. In this respect, we must ensure a more predictable EU budget to support employment and social inclusion via a minimum allocation to the European Social Fund, to strengthen

the European Globalisation Adjustment Fund and to rethink the current "Food for the Deprived" Programme.

The current under-financing of strategic investment projects across the EU, notably in trans-European networks and in research, is undermining Europe's future competitiveness and growth potential. This under-investment must be overcome through the development of Project Bonds and other innovative financial instruments. In parallel, the annual funding capacity of the European Investment Bank should be raised substantially.

6 BRINGING DOWN THE COSTS OF DEBT SERVICING

A common system of public debt issuance (so-called "Eurobonds") would reduce borrowing costs for the monetary union and increase its financial stability. In addition, to reduce Member States' vulnerability to financial market speculation and avoid the risk of contagion, the European Stability Mechanism should be given a banking licence, signaling to the markets that it is backed by the full power of the European Central Bank. The ESM and ECB should be prepared to intervene aggressively to restore market confidence in sovereign bonds, thus further reducing the burden of debt servicing on national budgets.

7 TRANSFORMING INDUSTRY - POLICIES FOR SUSTAINABILITY, INNOVATION AND COMPETITIVENESS

Europe needs growth, but not just any growth. Investment, both public and private, is the key policy instrument through which we can transform and modernize our economy. The European Investment Strategy will be directed towards sustainable growth, innovation, energy efficiency, eco-industries and the knowledge economy, areas which play to Europe's competitive strengths in the global economy and which will also help build a greener, smarter Europe. We shall use the investment strategy to promote an ambitious green growth agenda, as foreseen in the EU2020 goals, taking full advantage of the EU's leading position in the fields of energy and climate

The EU also leads in energy efficiency, renewable energy sources and waste management, industries with high growth potential, which will generate skilled, high-quality jobs. We will ensure a strong commitment to build on European strengths in science, engineering, education, R&D and innovation. European competitiveness demands that we be world class in these areas. None of that will be possible unless we match and surpass the levels of investment achieved by our trading partners.

8 BALANCED WAGES POLICY

Wage restraint is central to the right's "structural" solution to Europe's competitiveness problem. Yet the truth is that Eurozone labor costs have stayed in line with or below inflation - meaning that they have not eroded Europe's competitiveness. Wage developments have in certain countries been above and in others below productivity gains, fueling macroeconomic imbalances. The right's focus on holding down wages, deregulating the labor market and eroding social rights, against a background of high youth unemployment and growing social exclusion, is driven not by economics but by ideological prejudice. In most European economies, the share of wages in national income has fallen dramatically in the last 30 years, widening economic inequalities, leading to over-reliance on credit to sustain demand, and laying the ground for the financial meltdown of 2008. Moreover, the weakening of collective bargaining will intensify downward pressure on wages, therefore delaying recovery further. Reversal of this imbalance should be an explicit target of European economic governance, in particular by allowing wages to rise in countries in which productivity gains have been superior to wage increases. Especially during this crisis time, maintaining or raising the purchasing power of wage-earners - and especially low-wage earners - should be seen as a factor for social cohesion and the maintenance of internal demand, notably in countries experiencing trade surpluses. Coordinated collective bargaining should be strengthened across the EU, complemented by a European policy on minimum wages, respecting the different economic situations and national traditions of member states.

9 MAKING ECONOMIC GOVERNANCE ACCOUNTABLE AND FIT FOR PURPOSE

The recent revision of European legislation on the conduct of economic policy and the different decisions already taken to try and overcome the crisis have considerably reshaped the pre-crisis system of European economic governance. As a result, its

decision-making and policy processes have become horrendously complex, opaque and impossible for citizens to understand. This threatens Europe's democratic accountability and legitimacy. The EU and the Eurozone need more effective, more transparent and more democratic economic governance. An institutional reform is needed in this area, firmly resting on the so-called Community method with a strong role for the European Commission and for the European Parliament, which should become co-legislator in all areas related to the definition of European economic policy. The European Semester, the annual coordination process for economic governance, should be submitted to proper democratic debate at European and national levels.

10 STABILITY AND GROWTH - THE MISSING LINK

In order to lift Europe out of the crisis and onto a sustained growth path, a major weakness in the EMU and EU system of economic governance has, at last, to be addressed: this is the lack of integration of public investment spending into the rules governing the conduct of national budgetary policies. This can best be achieved by complementing the legislation on fiscal discipline with a new regulatory instrument focusing on growth and public investment within the set of rules on the conduct of fiscal policy - a new growth regulation.

The lack of recognition of public investment in Europe's budgetary policy rules has contributed to chronic under-investment and low growth in the European economy since the establishment of the convergence criteria. Neither the original Stability and Growth Pact, nor its 2005 revision acknowledged this problem. The recent "six-pack" legislation did not either integrate necessary provisions for public investment, as majorities in Council and Parliament chose to oppose such provisions as proposed by the S&D Group. The Fiscal Treaty only confirmed this restrictive approach to fiscal policy management.

Despite a wide literature confirming that public investment tends to fall as a result of fiscal adjustment, and the acute policy challenge posed by today's historically low levels of public investment in most European countries¹, EU leaders have been reluctant to revise the deficit rules to recognize the special role of public investment, for fear of weakening fiscal discipline. We are utterly convinced of the need for strict budgetary rules, to guard against abuses of the past. In the case of investment, strong safeguards can and should be readily built in by giving the Commission a central role in refining and monitoring the definitions and their application.

The existing set of regulations on fiscal policy-making must, therefore, be completed and reinforced with a new "Growth Regulation". This regulation will lay down binding rules and procedures for the monitoring and surveillance of national public investment spending, alongside the existing rules already applying to public deficits and debt. Its provisions of this growth regulation will have to be implemented within member states' national stability and growth programs and in the Commission's Annual Growth Survey recommendations.

As part of a new Stability and Growth Pact, a collective strategy to raise total EU public investment to at least 3% of GDP by 2017 should, in addition, be agreed upon by the European Council, for the achievement of which member states will have to commit themselves annually to minimum national public investment spending objectives.

¹ Public investment in Europe has fallen from an average 3.5% of GDP before the start of EMU to stabilise around an average 2.5% since the Stability and Growth Pact. However, this stabilisation (comparing 2000 vs 2010 levels) would amount to a further average fall when discounting the increases of public investment in a range of Eastern European countries, primarily Poland.