

Speech former Members on economic governance

63% of those participating in the latest Euro barometer believe that economic governance aimed at coordinating economic, fiscal and financial policies between member states is “effective”. Thus, people are much more forward looking and sensitive in view to the added value of European integration than are the governments. But always economic governance is a confrontative issue meaning national competence versus European openness.

At the same time respondents support the EU 2020 strategy especially in view to investment in people and SMEs. Nothing has changed in the debate since J.Delors White Book presentation 1993. Ideas have been great delivery has been poor especially on the side of national governments. So it is challenging to find now a way forward out of the crisis. Europe has to speak with one voice in order to defend its model of social market economy, the future role of Europe and the competitiveness of Europe which is necessary to contribute to sustainable growth and full employment. Europe is in need of economic governance. Europe has failed to coordinate in the first ten years of the Euro and paid a high price for this. Our EP initiatives failed. We tried during the 2nd stage since 1994 to participate as equals in the setting up of the broad economic guidelines. We tried to get a common position with the Council like in the co- decision process. Yet the other institution refused an interinstitutional agreement and just allowed for an informal dialogue twice a year in order to address the demands of the European Parliament. Only seldom we were invited to ECOFIN and the macroeconomic dialogue. Nevertheless, this commitment stands until today.

The convergence process has not been serious enough: Top down governance by statistics does not work especially if there is no real control. Not all problems are fiscal but Euro zone measures wrongly concentrated on fiscal challenges, worse, only addressed the expenditure side of fiscal policies. The implicit assumption in the Maastricht Treaty that threats to stability arise essentially from a lack of budgetary discipline has proven wrong: look to Ireland, Portugal and Spain. It even has proven that the frame for economic union has never been really used(art.121) and the Broad Economic guidelines have been just paper being disregarded by the national governments. There has been no surveillance over and above budgetary dimensions. Policy coherence is lacking and so are policy measures to reflect the principle of solidarity within the

EU. As the EP always underlined the participation in a Monetary Union has implications for policy much beyond the observance of the explicit treaty rules. A commitment to no- assistance is not credible and has never been enshrined in the Treaty. There is only a no- co responsibility principle for public debts. The availability of EU assistance does not weaken ex- ante- discipline given the experience with the IMF.

1. Following the Communication of 12 May on "reinforcing economic governance in Europe", the European Council of 17 June 2010 has endorsed the Commission initiative and requested concrete proposals. The Commission adopted a concrete toolbox to substantiate the initiatives. By using these tools, the gaps in the EU economic governance system will be closed which were so dramatically exposed by the crisis. The EU creates one single and integrated surveillance system for fiscal, economic and structural performance, by launching the European economic semester in January 2011. This may also contribute to re-establish the confidence in Europe's economy. Reinforcing the economic pillar of the EMU and the economic governance in Europe must create solid and lasting foundations for sustainable growth and job creation in order to save the European model of social market economy.

In the frame of the provisions of the Lisbon Treaty the commission proposes:

- To safeguard macroeconomic stability and to prevent harmful macroeconomic imbalances in the EU.**
- to reinforce the surveillance and correction of macroeconomic imbalances, with an alert mechanism and a corrective arm. Divergences in competitiveness and emerging macroeconomic imbalances will be reflected in a scoreboard, with alert threshold that would trigger in-depth analysis and action when flashing. In most serious and confirmed cases, the Commission would make country-specific recommendations and could also propose placing a Member State in an "excessive imbalances position". For euro-area countries, an enforcement mechanism in the case of serious and repetitive breach of recommendation could be envisaged.**
- to have an effective surveillance of structural reform in order to identify bottlenecks of growth and to attain the Europe 2020 objectives and the five headline targets (employment, social inclusion, research and innovation, education, energy and climate change). In case of insufficient**

progress, country-specific recommendations could again be issued.

- To integrate all these strands of surveillance, the key tool is the European semester. It would allow for prior coordination of economic policies, so that final decisions on the budget for the following year are taken by Member States. This does not mean interference but making sure that national budgets are consistent with EU commitments and they will not put at risk financial stability in Europe. All Member States would submit their Stability and Convergence Programs and their National Reform Programs at the same time in April to allow for ex-ante coordination.
 - then the second part of the year, Member States would finalize their budgets.
 - In order to strengthen the Stability and Growth Pact, excessive debt needs to be addressed with a clear benchmark for defining a satisfactory pace of debt reduction. Member States with debt ratios in excess of 60% of GDP could become subject to the Excessive Deficit Procedure if the decline of debt falls short of this benchmark.
 - Also national fiscal framework should better reflect the SGP objectives. National fiscal rules should also warrant the respect of the Treaty reference values on deficit and debt. Multi-annual budgetary planning and expenditure ceilings should be included too.
 - There is clearly a need to strengthen the credibility of EU's fiscal framework through a better enforced and more rules-based Stability and Growth Pact. That means having a wider range of sanctions and incentives, which are used preventively and invoked at an earlier stage. The incentive would consist of an interest-bearing deposit temporarily imposed to countries in persistent violation of their obligations under the pact, until this is corrected.
 - As regards the corrective arm, the proposal wants for all MS to use the EU budget as additional leverage to ensure respect of the Stability and Growth Pact. This means, for instance, expenditures under structural funds, agriculture spending, fisheries fund. In case of non-compliance with the rules, we foresee two early steps. First, suspension of commitments: this doesn't affect immediately on payments and allows time for correction. Second, if non-compliance with recommendations, it would imply the cancellation of suspended commitments (loss of payments).

- **On sanctions affecting agricultural payments: suspension would concern only transfers from the EU budget to the Government concerned. The Government would still be obliged to respect its commitment to the farmers. It would not hit the final beneficiaries.**

The proposals respect and reinforce the Community method, which is the key that makes the EU work and deliver. It is high time to reinforce the economic union in the EMU and create a genuine economic and monetary union.

The eurozone is often considered an experiment – a monetary union without political unification. Those who make this claim seem to have in mind a model of a single state, which possesses two relevant features: limited fiscal sovereignty for regional and local governments and a substantial common budget from which regions hit by asymmetric shocks can receive transfers.

Those who claim that “political union” is necessary for the eurozone appear to focus on the second feature, despite the fact that fiscal constraints on local governments are clearly a typical and important component of single states. In this sense, they ignore the fact that the European Union’s Stability and Growth Pact has been in principle an important component of political union, not its substitute. Indeed, the eurozone’s current fiscal problems do not result from the lack of a large common budget, but from weak enforcement of the Pact.

More fundamentally, monetary unions – in a broader sense – have existed not only within single states, but also in groups of sovereign states, the gold standard being the most notable example in history. The experience of such monetary unions offers two lessons. First, they required fiscal discipline in the member states, which was true under the gold standard, with its informal norm of balanced budgets. Second, they existed without any fiscal transfers from a common center, because such a center did not exist. Instead, a great deal of flexibility, including within

their labor markets, facilitated adjustment to asymmetric shocks.

It is clear that there is no scope in the foreseeable future to extend the EU budget in order to increase fiscal transfers to eurozone members affected by sharp declines in consumption. This would require an enhanced level of European identity, something which the Union's political elites cannot generate artificially. But the crucial point is not that a large common budget in the eurozone is politically impossible to achieve, but rather that it would not address the main problem: the weakness of the mechanisms safeguarding fiscal discipline in the member states.

Instead of looking at the wrong model – that of a single state – the EU and its member states should focus on the conditions required for the proper functioning of a currency union that has no common budget to compensate for asymmetric shocks.

First, utmost priority should be given to strengthening the mechanisms aimed at preventing pro-cyclical policies and large fiscal shocks. This requires ensuring the credibility and transparency of the accounting rules that define budget deficits and public debt, with closer monitoring also focusing on the development of asset bubbles, which cause deep recessions – and thus sharp increases in budget deficits – when they burst.

Likewise, the European Central Bank's monetary policy should “lean against the wind” by paying more attention to the development of asset bubbles. As the ECB's common monetary policy cannot fit the macroeconomic conditions of all the member countries, the eurozone countries need macro-prudential regulations that aim at reducing excessive credit growth. Meanwhile, the Stability and Growth Pact should be strictly enforced, which implies using and strengthening the available sanctions.

To be sure, initiatives at the EU and/or eurozone level cannot substitute for stronger mechanisms of discipline in the member states, which are ultimately the responsibility of national politicians and publics. But EU-wide measures aimed at ensuring discipline are necessary to spur the growth of preventive mechanisms in the member states, and such initiatives are largely dependent on the large countries, which thus bear a special responsibility for the developments within the eurozone – and within the EU.

Second, beyond strengthening economic institutions, EU countries must accelerate structural reforms to boost their long-run growth prospects and facilitate their smooth adjustment to shocks. The former are necessary to help Union members grow out of their increased public debt, while the latter would help them to address unemployment.

Of the many necessary measures in this area, the most important include a vigorous effort to complete the Single Market, coupled with avoidance of economic nationalism at all costs. Moreover, the Lisbon Agenda should be reinvigorated, with a focus on market reforms, and the EU should urgently reconsider measures – particularly regarding climate policy and the drift toward an EU-wide social policy – that risk imposing additional burdens on their economies and/or hamper the flexibility of markets.

In this respect, the mode of fiscal reforms is fundamentally important. As EU members already have large tax burdens, further tax increases would weaken the forces of growth. Thus, fiscal reform should focus on reducing the growth of spending commitments, which –given the aging of EU societies – must include raising the retirement age.

Finally, rigid labor markets and, more generally, regulatory constraints on prices and on the supply response of the economy, deepen recessionary reactions to various shocks, and contribute to the growth of unemployment. Therefore, labor-market liberalization should be a high

priority and another area of focus for the reinvigorated Lisbon Agenda.

European elites are fond of exclamations about “European solidarity,” “social cohesion,” and the “European social model.” But no amount of lofty rhetoric can substitute for the reforms outlined here – or obviate the need for them. Therefore the actual decisions are of importance. Which way will Europe choose?

Economic governance reform:

Europe urgently needs to reform its system of economic governance. But it does not need the changes proposed by the European Commission. While making progress in some important areas, they are a step backward in others and, above all, a missed opportunity to use the crisis to make changes that would enhance growth and employment opportunities in Europe and raise the welfare of Europe citizens. Europe's economic governance reform needs EU to emerge from the crisis and then to enjoy an extended period of growth that is economically, socially and ecologically sustainable. Or, if you prefer, what have we learnt from ten years of EMU and from the economic and financial crisis regarding the way Europe's economies, and the European economy developed in the 10 first years of EMU. Leaving aside financial markets, the following lessons had to be learnt:

1. Annual government deficits, even structurally adjusted, are a bad guide as to how a country is performing and whether it is acting appropriately in view of the needs of EU partners, and the same is true of debt levels, as the cases of Ireland and Spain clearly show; consequently simplistic quantified fiscal targets are not helpful. At the same time the stance of the private sector (businesses and households), and in particular its debt position, disregarded until now, is an important policy consideration. Both imbalances must be examined together.

2. Even within a monetary union large and persistent current account surpluses and deficits are dangerous and they are systematically promoted by the way that monetary union works;

consequently coordination mechanisms to ensure appropriate unit labour cost and price developments are needed.

3. Strong automatic stabilisers and discretionary counter-cyclical fiscal policy are needed to address both asymmetric shocks and, in conjunction with monetary policy, area-wide booms and busts;

4. The fiscal policy spillovers between countries are not just 'negative' (deficits in one country push up interest rates for everyone), but also 'positive' (expansionary fiscal policy boosts demand in other countries).

5. Tax competition undermines the basis for government revenues and increases inequality;

6. Punitive sanctions foreseen under the Stability and Growth Pact (SGP) cannot be imposed on countries that are in economic difficulties. Rather such countries require the solidarity of other E(M)U members in order to avoid contagion effects. This is best organised in the form of a standing crisis resolution mechanism.

7. Monetary policy sometimes needs the support of coordinated fiscal policy (for instance when at the zero bound), and the reverse is also true (for example when indebted countries face high interest rates on public debt).

8. The focus on micromanaging consumer price inflation is not always an appropriate sole rule for monetary policy as seen in US and UK.

The Commission's legislative proposals

The Commission's legislative drafts, which build on earlier proposals and are supposed to contribute to the EU's medium-term 2020 strategy (discussed here), make very little progress in converting these lessons into practical policymaking, and in some areas are worryingly regressive. The proposals can be summarised in three points:

1. The surveillance of fiscal policy under the SGP is reinforced further, notably by insisting on the respect of the debt criterion (60% of GDP) or a rapid pace of downward adjustment towards it (one twentieth of the gap between the current and target levels per year). The medium-term objective (MTO) of being 'close to balance or in surplus' is retained, but this is now specified to be achieved by focusing on government spending rather than revenues. The sanctions regime is tightened, coupled with a measure (the so-called reverse voting mechanism) that makes it harder for member states to block a Commission recommendation to impose sanctions.

2. The surveillance of Member States is also to be broadened, notably by incorporating an assessment of competitiveness and current account positions against a 'scoreboard' of relevant indicators. Modelled on the excessive deficit procedure in the SGP, an excessive macroeconomic imbalances procedure is to be instituted, which leads to country-specific recommendations by the Commission. If ignored, these can also result in financial sanctions imposed by the Council.

3. The coordination processes are to be streamlined in a new annual procedure known as the European semester. This has already been adopted by the Council, and is an integral part of the reform.

The assessment

The proposed reform package has two good things. In substantive terms the issue of macroeconomic imbalances is recognised as being of key importance for a coherent and sustainable economic strategy in Europe, and a procedure for assessing and, ultimately, correcting them established. At the procedural level, the European semester promises to intensify the degree of policy coordination in Europe, by establishing a common policymaking framework and timetable. These are important steps forward towards the needed coordination of economic policymaking in Europe. However, they are not enough to outweigh what is bad and what is missing.

Centerpiece of the reform is a heightened focus on fiscal consolidation. Something akin to Germany's 'debt brake' (Schuldenbremse) is to be instituted across Europe. This is bad for a number of reasons. Excessive fiscal profligacy was not a cause of the crisis, and is really only a critical problem in Greece (and even there on the revenue rather than the spending side). High fiscal deficits and debt are the result of the crisis -inevitable and indeed desirable. Certainly they should be reduced, but it is completely wrong to focus what is supposed to be a long-term reform of economic governance mechanisms on what is one single and medium-term policy requirement. Moreover, in the shorter run, if the injunction to reduce structural deficits by 0.5 percentage points (p.p.) a year and government debts on average by around 1 p.p. a year – indeed twice that in some countries – is taken seriously, the European economy will likely suffer a 'lost decade', if not worse. In such a context the new sanctions will not be worth the paper they are written on; they will be inoperable.

The proposed focus on the spending rather than the revenue side is unjustified, not least in the light of the problem of tax competition, which is not addressed at all by the proposals. The recommendation will lead to a steadily declining relative size of the public sector. Yet this and, more generally, the mix of measures on the expenditure and revenue side, can only be decided by democratically legitimated (national) parliaments and not by an unelected bureaucracy. This is a recipe for conflict between

Member States and the Commission that I cannot see the latter winning, even under the proposed new voting procedures.

Then there are two important sins of omission. No attempt is made when calculating deficits to allow for public investment spending that raises potential growth rates and thus promotes, in the medium run, fiscal consolidation. Governments facing political strictures to cut deficits and debt will slash public investment, as this is easier and quicker than reducing statutory entitlements. This is what happened in the run-up to EMU in many countries. This economic policy is incompatible with promoting the goals of the EU2020 strategy. Perversely, there is one exception to this logic (or rather illogic): countries that use tax subsidies to promote capital funded pensions schemes are to be permitted to set such spending against their deficits in contrast to investment in R&D or smart energy infrastructure, it is very arguable that such spending should sensibly be considered an investment.

Similarly, no measures to incentivise countries to strengthen their automatic stabilisers are foreseen, although there is a clear European value-added to such coordinated efforts, which would make a major contribution to stabilising demand and output.

Ideally Europe would need a mechanism for establishing the desired aggregate fiscal stance given the expected economic situation and then the appropriate allocation of national fiscal positions, such as to take account of national and the overall European requirements. This would almost certainly involve some (limited) fiscal transfers between countries. Clearly that is too difficult. But by focusing on fiscal issues, and intensifying the pressure on national policy to achieve a uniform medium-term objective for fiscal policy of 'close to balance', while ignoring sensible reforms like taking out investment, the proposal is not helpful.

The close-to-balance rule, however sensible it may appear at first sight, has implications that are not always benign and can, under realistic conditions, can be highly damaging. First of all they imply zero government debt in the longer term. There is no sound economic argument why that is optimal, and no government of an advanced country has come even close to being debt-free since the dawn of capitalism. Moreover, adhering to such a rule forces the two other sectors, the private sector and the external balance to precisely offset each other. If desired national savings are higher (or lower) than investment then the current account will be in surplus (or deficit) to precisely the same degree. If, under the 'excessive macro imbalances' procedure these are to be prevented then the private sector will be forced to adjust. The imbalance between desired savings and investment will be forcibly rectified by lower output growth. Even if it seems counter-intuitive from the point of view of an individual, this is why it is actually sensible for governments to post repeated (but sustainable) deficits year-in, year-out.

The problem is that, because of the interaction of sectoral balances, the reform proposals are actually incoherent. The only sensible solution is to focus primarily on the external (i.e. current account) balances, which have been shown by the crisis to make countries so vulnerable, and as part of that to examine fiscal positions, rather than to prioritise the public over the private sector (im)balance. In other words the debt position of the public and private sectors (which together are equal and opposite to the current account position) of each country should be examined in equal measure, at the same time and in one single procedure. Such an examination would quickly reveal that, in most countries most of the time, it is changes in private savings and investment behaviour, rather than public debt that are the prime source of imbalances. More importantly in policy terms, it would foster Europe's economic recovery by leading to sensible policy recommendations, notably that countries with large surpluses on current account (above all Germany) should continue with stimulus measures, while deficit countries consolidate earlier.

Although the macro imbalances part of the proposals constitutes an important step forward, concerns remain even here. Of concern is that the entire process appears to be based on an interaction between the European Commission (read: DG Ecfm) and national governments (read: finance ministries). Yet key to competitive imbalances are wage and price developments, and thus labour markets and collective bargaining institutions: they are the responsibility of other actors, but there is no indication of how they are to be incorporated. The EU has an institution, the Macroeconomic Dialogue, that could be strengthened and expanded to help coordinate adjustments of nominal wage and price trends. Yet inexplicably there is no mention of this in the proposals. It seems that policymakers are sticking to the faith that, if only there is enough 'structural reform', wage and price setting will be so 'flexible' that adjustment will be achieved via competitive pressures. The most benign interpretation of this is that it is the triumph of hope over the experience of ten years of EMU.

Given that the legislative proposals are touted as a reform of economic governance, it is somewhat surprising that there is not a single mention of the role of monetary policy within the broader economic governance framework. The ECB was seemingly created in some secular version of the 'immaculate conception', and as such the crisis has no implications for its conduct. Yet this is obviously incorrect. Two examples, one from the past, one from the present. The focus on fine-tuning inflation by the world's leading central banks did not prevent the second-largest crisis of capitalism, recently estimated to have cost the equivalent of at least one entire year's global output. And we now have a situation where the ECB lends money to banks for virtually nothing. The banks lend it to national governments at up to eight percent, a debt which has to be serviced by hard-pressed tax payers.

The ECB cannot simply be treated as sacrosanct. Inflation targeting could be supplemented by more explicit mandates to consider financial stability, growth and employment. The looting of taxpayers by banks, with the ECB as accomplice, could be stopped overnight if the ECB simply extended credit to national governments (directly or indirectly through some support scheme). Addressing such

crucial issues would require a genuine reform of Europe's economic governance rules. Instead what is on the table is to a considerable extent an intensification of a long-standing but evidently unjustified and unhealthy obsession with fiscal deficits and debt, plus a basically sensible, yet flawed, extension to macroeconomic imbalances.

Concrete and creative alternative proposals to, for example, take account of public investment, develop the Macroeconomic Dialogue, bring monetary policy into a genuine economic governance and provide balanced incentives and credible sanctions for good/ bad behavior.

The suspension of voting rights for member states breaching the rules is not acceptable. To disenfranchise countries that are already suffering from a lack of EU coordination would be a wrong direction for Europe.

Important elements are missing from the economic governance plans:

- **A monitoring system for employment and social levels (as key indicators of economic strength).**
- **A commitment to push for an EU financial transaction tax, bank levies and to seriously explore the idea of Eurobonds.**
- **An alternative to the proposal to withhold EU structural funds from Member States who infringe budget guidelines.**
- **Greater coordination on EU Economic proposals with EU and Employment Ministers.**
- **A clear commitment to a permanent crisis and debt-management mechanism.**

There are too many essential policy ideas missing in the Conservative approach to economic governance. This biased reform, with focus only on fiscal consolidation, promotes division between member states rather than cooperation. It is merely a blueprint for austerity. We need measures and instruments to support growth and jobs. We need means of governance that develop positive cooperation, and not just limit negative effects.

Economic Governance of Fair Growth

Declaration on a balanced approach on EU economic policy coordination

agreed by the PES Prime Ministers and Deputy Prime Ministers

The Party of European Socialists (PES) has consistently been calling for a real, effective and

positive European coordination of economic policy. While the Conservatives push for a

coordination architecture solely based on austerity measures and sanctions, we offer a new,

more inclusive deal on economic governance reform, capable of delivering the right type of

policies. A deal which is fiscally responsible, socially fair, economically efficient and that

ensures economic convergence and stronger welfare systems. A deal which would put us on the path towards fair growth.

Regarding strengthening and broadening macroeconomic surveillance, it is just as important to consider the labour market and the social situation of a given country as it is to consider its fiscal position. This means that we must insist on including employment and unemployment rates as well as levels of e.g. poverty and social expenditure as indicators on the scoreboard for surveillance. The aim of this is not to punish countries with excessive unemployment or high levels of poverty and social exclusion, but to enable an assessment of support needed from EU level. A broader and more balanced surveillance also requires more balanced governance. All relevant Council formations, including EPSCO, should therefore be involved in the coordination of European economic policy and on dealing with the Europe 2020 strategy. The European Council should have the central role in this coordination, supported by the General Affairs Council. Moreover, balanced efforts should be made both by member states with an account deficit and by countries with an account surplus;

By strengthening coordination of economic policies through a “European Semester”, there is a need to ensure that budgets and national reform programmes are mutually reinforcing.

There should not be a hierarchy between implementing the Europe 2020 strategy and macro-economic governance;

To ensure discipline, there are sanctions laid down in the Stability and Growth Pact. We are open for discussion on how to improve fiscal discipline. However, the EU structural funds should not be a part of sanctions. Instead, they should be used as positive incentives for structural reforms and social cohesion;

In order to rebalance the national budgets, an effective, sustainable and socially balanced

consolidation of public finances with medium term expenditure reductions is necessary. But this needs to be complemented by the creation of new sources of revenue, including a financial transaction tax (FTT) and bank levies. Furthermore, the joint issuance of eurodenominated bonds (“Eurobonds”) should be seriously explored.