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REPORT

on the communication from the Commission to the Council and the European Parliament on public finances in EMU – 2003
(COM(2003) 283 – C5–0377/2003 – 2003/2151(INI))
Committee on Economic and Monetary Affairs

Rapporteur: Roberto Felice Bigliardo

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PROCEDURAL PAGE

By letter of 22 May 2003 the Commission forwarded to Parliament a communication on public finances in EMU – 2003 (COM(2003) 283), which had been referred to the Committee on Economic and Monetary Affairs for information.

At the sitting of 4 September 2003 the President of Parliament announced that the Committee on Economic and Monetary Affairs had been authorised to draw up an own-initiative report on the subject under Rules 47(2) and 163, and the Committee on Budgets had been asked for its opinion (C5–0377/2003).

The Committee on Economic and Monetary Affairs had appointed Roberto Felice Bigliardo rapporteur at its meeting of 20 November 2002.

The committee considered the draft report at its meetings of 30 September, 7 October, 4 November 2003, 20 January 2004 and 27 January 2004.

At the last meeting it adopted the draft resolution by 20 votes to 13, with 0 abstention.

The following were present for the vote: John Purvis (acting chairman), Philippe A.R. Herzog(vice-chairman), Roberto Felice Bigliardo (rapporteur), Generoso Andria, Pervenche Berès, Hans Blokland, Jean-Louis Bourlanges (for Renato Brunetta), Hans Udo Bullmann, Benedetto Della Vedova, Manuel António dos Santos (for Helena Torres Marques), Harald Ettl (for David W. Martin), Jonathan Evans, Carles-Alfred Gasòliba i Böhm, Lisbeth Grönfeldt Bergman, Mary Honeyball, Christopher Huhne, Pierre Jonckheer (for Alain Lipietz), Othmar Karas, Giorgos Katiforis, Christoph Werner Konrad, Werner Langen (for Piia-Noora Kauppi), Astrid Lulling, Thomas Mann (for Hans-Peter Mayer), Ioannis Marinos, Peter Michael Mombaur (for Mónica Ridruejo), Fernando Pérez Royo, Bernhard Rapkay, Olle Schmidt, Peter William Skinner, Bruno Trentin, Ieke van den Burg (for Robert Goebbels), Theresa Villiersand Brigitte Wenzel-Perillo (for Christa Randzio-Plath pursuant to Rule 153(2)).

The Committee on Budgets decided on 11 September 2003 not to deliver an opinion.

The report was tabled on 29 January 2004.

DRAFT EUROPEAN PARLIAMENT RESOLUTION

on the communication from the Commission to the Council and the European Parliament on public finances in EMU – 2003
(COM(2003) 283 – C5–0377/2003 – 2003/2151(INI))

The European Parliament,

– having regard to the communication from the Commission (COM(2003) 283 - C5–0377/2003),

– having regard to its resolution of 12 March 2003 on the communication from the Commission on public finances in EMU[1],

– having regard to the communication from the Commission to the Council and the European Parliament entitled 'Strengthening the co-ordination of budgetary policies' (COM(2002) 668),

– having regard to the communication from the Commission to the Council and the European Parliament on structural indicators (COM(2002) 551),

– having regard to the ECOFIN Council decision of 5 November 2002 on the existence of an excessive deficit in Portugal and on the adoption of a recommendation of necessary measures to combat the deficit[2],

– having regard to the ECOFIN Council decision of 21 January 2003 on the existence of an excessive deficit in Germany and on the adoption of a recommendation of necessary measures to combat the deficit[3],

– having regard to the ECOFIN Council decision of 3 June 2003 on the existence of an excessive deficit in France and on the adoption of a recommendation of necessary measures to combat the deficit[4],

– having regard to the Commission recommendation of 8 October 2003 to the Council to decide that France had taken no effective action in response to the Council Recommendation according to Article 104(7) within the period laid down in that Recommendation,

– having regard to the July 2003 report entitled 'An Agenda for a Growing Europe' by a high-level group established on the initiative of the President of the European Commission and chaired by André Sapir,

– having regard to the Presidency Conclusions adopted by the European Council in Lisbon on 24 March 2000 and in Gothenburg on 15 and 16 June 2001, with particular reference to the strategy agreed on with respect to economic growth, full employment, sustainable development and social cohesion,

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[1] P5_TA(2003)0092..
[2] OJ L 322, 27.11.2002, p. 30.
[3] OJ L 34, 11.2.2003, p. 16.
[4] OJ L 165, 3.7.2003, p. 29.

– having regard to the Presidency Conclusions adopted by the European Council in Stockholm on 23 and 24 March 2001 and in Barcelona on 15 and 16 March 2002, with particular reference to the 'Stability and Growth Pact' and the budgetary challenges, including the quality of public finances in the light of demographic change,

– having regard to the conclusions of the Italian Presidency adopted by the European Council in Brussels on 16 and 17 October 2003, with particular reference to the 'Growth Initiative',

– having regard to Rules 47(2) and 163 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A5-0044/2004),

A. whereas at the end of 2003 the economic recovery heralded by the Commission in its previous economic forecasts has yet to materialise; whereas, *inter alia* due to a lack of structural reforms in many Member States, the GDP growth rate for the euro zone has fallen once again in 2003 and has now declined from 3.5% in 2000 to 1.5% in 2001, 0.9% in 2002 and 0.5% in 2003, leaving Europe's economy on the brink of stagnation,

B. whereas public and private investment alike across the European Union as a whole has fallen sharply by 2.4%, thereby further weakening growth,

C. whereas geopolitical events such as the war in Iraq and SARS have been particularly damaging to confidence in the economy and growth in Europe,

D. whereas the appreciation of the euro against the dollar could bear risks in the medium-term for the competitiveness of the European economy and its exports in particular,

E. whereas in 2002 the euro-zone budget deficit rose to 2.2% of GDP from 1.6% in 2001 and 1.1% in 2000, and is likely to approach 3% of GDP in 2003,

F. whereas at the end of 2002 only four countries in the euro zone – together accounting for a mere 18% or so of the euro-zone GDP – had reached a close-to-balance position, and whereas, conversely, three countries had exceeded the figure of 3% of GDP,

G. mindful of the three excessive deficit procedures initiated hitherto against Portugal, France and Germany,

On the current state of public finances in the Member States

1. Notes that, in the Commission's view, the economic cycle is only partly to blame for the higher nominal deficits, which are in fact largely the result of a discretionary loosening of budgetary policy on the part of some Member States;

2. Notes that, in response to the instigation of excessive deficit procedures against them, some countries have not taken sufficient measures to combat their respective deficits, and that there remain sufficient grounds for concern regarding the prospects for bringing their deficits below the figure of 3% of GDP in the immediate future;

3. Notes that, pursuant to Article 104(8) of the EU Treaty, on 8 October the Commission recommended to the Council that it take note of France's failure to introduce specific

measures to bring its public deficit below the 3% of GDP mark in 2004;

4. In this regard, calls on France and Germany to demonstrate their commitment to comply with the Stability and Growth Pact and to take measures to consolidate their public finances, so as to avoid the need for sanctions;

5. Notes that the French Government has undertaken a first step in implementing structural reforms (pension reform, implementation of social security reform) which should be highly beneficial to public finances in the long term but which will not bring down the budget deficit in the immediate future;

6. Calls therefore on the Commission to put forward the necessary adjustments for a more intelligent application of the Stability and Growth Pact in line with the Lisbon objectives;

7. Highlights the importance of introducing structural reform packages which in the medium and long term will prove crucial for financial sustainability, for the competitiveness of the European economy and for growth ;

8. Congratulates the Commission for the progress achieved in terms of methods towards improving the EU budgetary surveillance framework, both by including the applicant countries in the framework and improving the process under which budget statistics are drawn up ;

On the accession countries

9. Notes that the management of the economic changes in the countries of central and eastern Europe has in some accession countries had a heavy impact on their deficit and public debt levels;

10. Urges the accession countries to reduce their deficit levels significantly to below 3% of GDP to ensure fiscal and price stability in an enlarged European Union; recalls that entry to EMU is subject to the four convergence criteria pursuant to Article 121 para. 1 TEC and its protocol;

11. Urges the accession countries to speed up reform of their public finances by reallocating resources as a further move towards ensuring the genuine convergence of their economies and to focus in particular on the modernisation of their pension and social benefits systems in support of an effective employment policy;

12. Stresses the need for continuous improvements in fiscal administration and the establishment of an effective tax collection system;

On potential proposals

13. Reminds the Member States of their commitment in the Stability and Growth Pact to bring the budgets 'close to balance or in surplus'; stresses the importance of balanced budgets and price stability as prerequisites for sustainable growth;

14. Reiterates its call for a clear method that includes a definition of ‘high-quality public expenses’ to quantify public budgetary positions and their contribution to growth and investment with a view to making a positive contribution to the Lisbon goals;

15. Welcomes the Commission proposal on the list of structural indicators and calls on the Commission to establish a precise definition of the concept of a structural deficit;

16. Regrets the ECOFIN decision of 25 November 2003 to stop the Deficit Procedure against Germany and France;

17. Supports the Commission in its determination to strictly adhere to the provisions of the Stability and Growth Pact and to bring the ECOFIN decision of 25 November 2003 before the ECJ;

18. Congratulates the Italian Presidency on its initiatives for growth in Europe, and calls on future presidencies of the Union and of the Council to pursue this route further by working towards a genuine internal growth strategy for the European economy;

19. Considers, however, that a real boost to the European Union's productivity and economic potential requires an increase in budgetary allocations at European and national level in order to support more effective European-wide investment;

20. Is of the opinion that in the interest of boosting public and private investment it is of high importance to go beyond the current European-wide public spending limit of 0.8 % of GDP, whilst insisting that there is room for manoeuvre in spending between 1% and 1.27% of GDP 2004-2006 in line with the present financial perspective 2000-2006 and the Lisbon objectives as well as with the promotion of private investment activities; furthermore calls to redirect public expenditure in the way that the various budget headings at European and national level reflect the major political priorities set for 2010;

21. Is of the opinion that a mid-term evaluation of the European Action for Growth should be provided to both the European Council and the European Parliament by 2006 in order to allow conclusions to be drawn for the new Financial Perspective 2007-2011 and the new funding period of the EU Structural funds; calls for the European Parliament to be fully involved in the mid-term evaluation of the Action for Growth and invites the EIB to report on its preparatory work to the European Parliament as soon as possible; calls, in addition, for regions which have to date been beneficiaries of the structural funds to continue to be eligible following enlargement, on the basis of new parameters;

22. Instructs its President to forward this resolution to the Council, the Commission, the Economic and Social Committee, the Committee of the Regions and the parliaments of the Member States.

EXPLANATORY STATEMENT

The current state of public finances in the Member States

In 2003 the European Commission has been obliged to revise its economic forecasts downwards for the third year running. The rate of GDP growth in the euro zone in 2003 has fallen once again, from 3.5% in 2000 to 1.5% in 2001, 0.9% in 2002 and 0.5% in 2003, which means that the European economy is close to stagnation. The sharp fall in public and private investment alike –2.3% in the euro zone and 2.4% in the European Union as a whole – has further weakened growth. Geopolitical events such as the war in Iraq and SARS have been particularly damaging to confidence in the economy and growth in Europe. Furthermore, the euro has made strong gains against the dollar, eroding the competitiveness of the European economy and hurting exports in particular.

Budgetary developments

In 2002 the budget deficit in the euro zone amounted to 2.2% of GDP, compared with 1.6% of 2001 and 1.1% in 2000 and is likely to approach 3% of GDP in 2003. This figure masks the considerable differences between EU Member States. In 2002 only six Member States – including four from the euro zone together accounting for a mere 18% of the euro zone's GDP – had reached a close-to-balance position. Three Member States – including France and Germany, which together account for about half of euro-zone GDP – had contracted budget deficits exceeding the 3% of GDP threshold.

Excessive deficit procedures

Hitherto three excessive deficit procedures have been initiated, these being against Portugal (4.1% deficit in 2001) and against France and Germany (budget deficits of 4% and 3.8% respectively in September 2003).

However, the countries concerned have reacted in remarkably different ways. Portugal and Germany gave immediate undertakings to comply with the common budgetary framework, have taken measures to combat the excessive deficits as a sign of their resolve to abide by the rules of the Stability and Growth Pact, and are striving to reduce their deficits within the time limit.

Portugal

The Portuguese Government brought its nominal deficit down from 4.1% in 2001 to 2.8% in 2002. Although Portugal's public finances have suffered from a sharper than expected economic slowdown in 2003, it would appear that the general government deficit could be kept below 3% of GDP, thanks in the main to a raft of one-off measures and to extraordinary revenue. In addition to selling off EUR 1 billion of state assets, the Portuguese Government will be employing financial engineering techniques in the form of the securitisation of claims for the recovery of EUR 500 million in tax and social security arrears. However, in the Commission's view uncertainties remain, particularly as regards reliance on a large number of one-off operations that could amount to 1.1% of GDP.

Germany

In 2002 Germany found itself with an excessive deficit amounting to 3.6% of GDP. In spite of the measures taken by the German authorities to bring down the deficit, it would appear that the nominal deficit has actually risen slightly during 2003 as growth conditions have deteriorated. Germany is unlikely to succeed in bringing the deficit below the 3% mark in 2004.

France

France has decided not to embark upon a policy that it considers procyclical and likely to aggravate the recession-like circumstances in which it finds itself, preferring to engage in essential structural reforms rather than short-term one-off measures. Thanks to the implementation of vital pension and social security reforms, France has made provision for a reduction in the structural deficit of 0.7% of GDP in its 2004 finance bill. On 8 October 2003 the Commission noted that France had failed to take specific measures in response to the Council recommendation of 3 June 2003, including the recommendation to bring its public deficit below the 3% of GDP mark in 2004, and recommended that the Council take note of this situation, in accordance with Article 104(8) of the EU Treaty. In the Commission's view France's growth forecast of 1.7% of GDP for next year is realistic, but it is asking for further efforts to bring down the structural deficit by 1% of GDP in 2004 and 0.5% in 2005, so as to ensure that the public deficit falls below the 3% of GDP mark once again in 2005. The Commission's recommendations will be discussed by economic and finance ministers on 4 November. France will then have two months, i.e. in until the end of December, to explain how it intends to implement these recommendations; failure to do so could result in sanctions against it.

Your rapporteur calls on France to give further evidence of its resolve to comply with the Stability and Growth Pact; he further calls on France to enter into negotiations with the Commission to find a compromise on the measures concerned and on the most appropriate and feasible plan of action for consolidating its public finances and, therefore, avoiding sanctions.

Debate on the Stability and Growth Pact

Your rapporteur would like to emphasise the importance of not calling the Stability and Growth Act into question at a time when the European economy is slowing down. Although the Stability and Growth Pact is still in its infancy and is experiencing some teething troubles, this particular infant must be allowed to grow, learn, adapt and expand its horizons. The debate on the budgetary policy framework, and on the Stability and Growth Pact in particular, has become increasingly lively of late, with a number of economists weighing into the debate. The following issues have been pinpointed as the Achilles' heel of the rules and their enforcement:

- criteria for issuing a warning: the annual budget deficit criterion, currently the only criterion in respect of which non-compliance can result in sanctions, ought to be replaced by a criterion linked to the sustainability of the public debt in accordance with the aim of ensuring long-term budgetary stability;
- lack of flexibility: the rules should be interpreted on a case-by-case basis, with all relevant aspects taken into account; furthermore, the Stability and Growth Pact should not become an obstacle to vital structural reforms which, whilst perhaps pushing deficits up in the short term, would lay down sound bases for economic stability in the long run;
- sustainability: without growth there can be no sustainable basis for stability. The Pact does not contain a sufficient number of elements to ensure growth;

- investment: budgetary consolidation under EMU and the Stability and Growth Pact has led to a decline in investment;
- lack of credibility: this stems from the fact that the authority to issue a warning remains in the hands of those who may receive such a warning. Greater independence from short-term national political interests is required here;
- ‘one size fits all’: the ECB’s single monetary policy ‘endorses’ and aggravates the economic slowdown in countries whose economy is stagnating or even in recession;
- the procyclical aspect: the Stability and Growth Pact compels countries to consolidate their budgets during slowdowns, whilst failing to offer them enough encouragement to do so during periods of growth.

Your rapporteur congratulates the Commission on its November 2002 communication on strengthening the coordination of budgetary policies, in which it sets out five proposals to improve and strengthen the interpretation of the SGP, make the economic climate and the debt-to-GDP ratio factors in budgetary surveillance, and guarantee stricter compliance with the objective of sound and sustainable public finances.

Likewise, your rapporteur backs the proposal in the report entitled ‘An Agenda for a Growing Europe’, which suggests clarifying and altering the definition of ‘exceptional conditions’ by replacing the -2% growth criterion with a negative-growth criterion.

In the current circumstances your rapporteur raises the issue of the difficulty of striking a balance between medium- and long-term structural reforms with only a long-term impact and the strict terms of the Stability Pact with their apparent preference for short-term, one-off measures. Your rapporteur highlights the importance of introducing reform packages which in the long term will prove crucial for financial sustainability, for the competitiveness of the European economy and for growth, but which may have no immediate impact and in some instances may even briefly result in an increase in the deficit. He also suggests that the Commission show greater flexibility towards Member States which are credibly and openly committed to medium- and long-term structural reforms.

Your rapporteur reiterates Parliament’s call for a clear method that includes a definition of ‘high-quality public expenses’ to quantify public budgetary positions and their contribution to growth and investment with a view to making a positive contribution to the Lisbon goals, and hopes that the list of structural indicators will form an integral part of the budgetary surveillance framework and of national stability and convergence programmes.

In this regard your rapporteur calls on the Commission to consider the recommendations contained in the Sapir report, ‘And Agenda for a Growing Europe’, and in particular the recommendations on support for education and R&D policies and on setting up an EU restructuring fund to accompany the implementation of structural reforms.

Accession countries

The transition undertaken by the new Member States has been remarkable and by and large successful. In the majority of cases the private sector has become ever more competitive and productive, thanks in the main to foreign investment. However, further public sector reforms are required.

On average, budget deficits are getting worse, having increased from 3.8% of GDP in 2001 to 4.7% in 2002. A slight improvement (4.2%) is forecast for this year. Seven of the ten new Member States are expecting to have a deficit in excess of 3% of GDP. Most of them have enjoyed a relatively low level of public debt – the average is still about 40% – but Commission analyses indicate that, in a no-change scenario, by 2015 it could have reached almost 52%, or even be as high as 57% if the conditions for growth prove less favourable still.

As far as public finances are concerned, there is evident need for reform in three main areas:

- firstly, a brake will have to put on the growth in public structural expenditure, which is already high, principally because of the aim of the social system to soften any blows resulting from the move from a planned economy to a market economy. Although tangible progress has been made in this area, reform of pension schemes remains one of the major reforms still required;
- secondly, better management of public spending will be required to prevent budgetary policy from becoming procyclical and jeopardising a further fall in inflation;
- lastly, adequate means will have to be found to cofinance projects under the Structural Funds, and in more general terms there will have to be restructuring of public budgets to make for more productive expenditure.

In accordance with the EU Treaty, future Member States will be unable to adopt the euro immediately upon accession; instead, they will be required to join the ERM II sometime after accession for a period of at least two years. Although the future Member States' ultimate aim is to join the euro zone, the criteria relating to public finances may determine the final decision, and may even form grounds for rejection from EMU.

Strengthening the 'growth' pillar

Your rapporteur congratulates the Italian Presidency on its initiatives for growth in Europe with a view finally to placing the emphasis on growth in the implementation of the Stability and Growth Pact, and calls on future presidencies of the Union and of the Council to pursue this route further by working towards a genuine internal growth strategy for the European economy.