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REPORT

on public finances in economic and monetary Union (EMU)
(2005/2166(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Dariusz Rosati

PR_INI

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on public finances in economic and monetary Union (EMU)
(2005/2166 (INI))

The European Parliament,

– having regard to the Commission communication on Public finances in EMU - 2005 (COM(2005)0231),

– having regard to the Commission's integrated guidelines for growth and jobs (2005-2008) (COM(2005)0141),

– having regard to the Commission's Economic forecasts of Autumn 2005[1],

– having regard to Council Regulation (EC) No 1056/2005 of 27 June 2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[2],

– having regard to the Council Recommendation to Italy of 12 July 2005, with a view to bringing an end to the situation of an excessive government deficit[3],

– having regard to the Council Decision of 22 September 2005 abrogating Decision 2005/136/EC of 2 June 2004 on the existence of an excessive deficit in the Netherlands[4],

– having regard to the Council Recommendation of 7 October 2005 with a view to bringing an end to the situation of an excessive government deficit in Portugal[5],

– having regard to the Council Decision of 8 November 2005 establishing, in accordance with Article 104(8) of the Treaty establishing the European Community, that the action taken by Hungary in response to the Council recommendation of 8 March 2005 pursuant to Article 104(7) of the Treaty is proving to be inadequate[6],

– having regard to the Council Decision of 24 January 2006 on the existence of an excessive deficit in the United Kingdom[7],

– having regard to the European Trade Union Institute 2005 Annual Report on the Coordination of Collective Bargaining in Europe,

– having regard to the IMF World Economic Outlook on Globalization and External

[1] European Economy, No 5/2005.
[2] OJ L 174, 7.7.2005, p.5.
[3] 11124/05, ECOFIN 242.
[4] 11898/05, ECOFIN 269.
[5] 12401/05, ECOFIN 289.
[6] 14101/05, ECOFIN 337.
[7] 5366/06, ECOFIN 11.

Imbalances of April 2005,

– having regard to Rule 45 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A6-0162/2006),

1. Expresses its concern about, first, the persistently slow growth in Europe since 2002, accelerating, in the euro zone, only gradually from 0,6% in 2003 to 1,3% in 2005, in contrast with the growth rates of the USA of 3,5% in 2005 and the rebound of Japan's economy driven by private final domestic demand, second, the persistently high unemployment of 9% in EU-25 and 8,1% in EU-15 and, third, about the output gap, currently at -1% of GDP, demonstrating that EU economic growth remains substantially below long-term potential, constrained by structural rigidities, weak internal demand, and a lack of proper balance in the macroeconomic policy mix; stresses that the European economy's potential for growth remains excessively low, at about 2%, a figure much lower than that registered elsewhere in the world; considers that this potential for growth is insufficient for job creation and reducing unemployment rates or for the development of the enlarged Union;

2. Stresses the risk of rapid adjustments to the global imbalances which could lead to a decrease in demand in the US thus resulting in lower exports and weaker growth in the EU, and stresses that this effect could be further magnified by fluctuations in the euro exchange rate against the US dollar;

3. Notes the adverse implications of oil-price volatility and increases on internal demand and growth in the EU and the threat of its secondary effects; welcomes the responsible behaviour of social and economic actors to prevent these implications, notwithstanding weak household consumption; points out that a stable, outward-looking and competitive macro-economic policy-setting is a necessary precondition for a sustainable public finance policy;

4. Expresses its concern in regard to weak private consumption, especially in certain Member States, which has contributed to low growth rates in the EU and thus to the current global imbalances, and which is due to the prevailing climate of uncertainty about jobs and pensions, the persistent high level of unemployment, and the slow growth of real wages; recalls the commitment to promote nominal wages and labour cost developments consistent with price stability and the trend in productivity over the medium term in Integrated Guideline 4;

5. Welcomes the upturn in the pace of investment expenditure due to the revival of confidence among entrepreneurs and current stabilised profit margins, as referred to in the Autumn 2005 economic outlooks of both the IMF and the Commission; considers that there is still room and need for further acceleration in investment activity and thus calls for structural reforms and additional measures that would permanently improve the investment climate and boost investments;

6. Calls for the reorientation of public expenditure towards physical and human capital

accumulation and the creation of public-private partnerships operating in areas of innovation, renewable energies, education and training, research, information technologies, telecommunication, and transportation networks etc;

7. Regrets that the EU Financial Perspective for 2007-2013 does not reflect sufficiently the priority given to the expenditures in the objectives of the Lisbon Strategy; stresses that the contributions to the European budget should be considered against future benefits taking into account their positive spill-over and leverage effects, providing the EU budget is sufficiently orientated towards expenditures bringing clear added value;

8. Notes that healthy public finances is not a goal in itself but a means by which Member States meet their public duties; stresses the importance of healthier fiscal positions for qualitative growth, job creation and the Lisbon Strategy but notes that, owing to the incorrect application of the Stability and Growth Pact in spite of the fiscal framework, no significant improvement regarding the Member States' fiscal positions has been achieved since last year; notes that most Member States, whether or not participating in the euro zone, have not yet achieved the medium-term objectives as regards their balance of payments; notes that the deficit for 2005 reached 2.9% of GDP in the euro zone and 2.7% across the EU, and that eleven Member States have deficits exceeding 3% of GDP, among which are the four largest EU economies, namely France, Germany, Italy and the UK, and that since summer 2004, ten Member States have been subject to the excessive deficit procedure;

9. Stresses the importance of actions to address persistent fiscal pressures; welcomes Member State authorities' articulation of policies and public commitments to reduce fiscal deficits;

10. Expresses its concern about the prospects of long-term budgetary sustainability considering the increase of public debt ratios from 69,2% in 2002 to 71,7% in 2005 in the euro zone and from 61,4% in 2002 to 64,1% in 2005 in EU-25, due to the weak growth of GDP and the lack of determined effort to reduce budgetary imbalances through structural reforms;

11. Stresses that in the context of an EU with low consumer and investor confidence, it is vital to correct public deficits; is disappointed by the recent trends in public finances, noting that the Member States' deficits remain much higher than required by the European economy; notes that governments are using the low growth argument to justify the deficits,,despite the fact that the deficits are impeding economic recovery and making the cycle more acute; calls for a reduction in public deficits in 2006 which is much more ambitious than a mere economic adjustment made in anticipation of higher European growth;

12. Calls for more transparency in the public finances of individual Member States, including the as regards implicit liabilities such as public sector pension commitments, which will significantly raise the burden of debt of the public sector over the coming years;

13. Recalls its demand to avoid pro-cyclical policies; stresses the importance of undertaking

structural and tax reforms and simultaneously underlines that due attention should be paid to their proper timing;

14. Encourages further research into the different kinds and measures of structural and macroeconomic reforms and their interaction and mutual impact at different phases of the economic cycle in order to identify the best possible means of strengthening public finances while at the same time realising the Lisbon Strategy;

15. Underlines that the lack of political will to contain public spending, overoptimistic revenue projections, creative accounting, and fiscal consolidation based mainly on one-off measures, have largely contributed to budgetary slippage and the weakness of the fiscal framework ;

16. Recommends exploring whether to set a uniform calendar for budgetary procedures across the EU, possibly on a biannual basis; takes the view that the Member States' budget planning must be based on uniform assumptions regarding key economic parameters such as trends in oil prices and exchange rates; thus calls for key economic parameters to be uniformly assessed and established across the EU;

17. Calls upon the Member States to address urgently the challenge of an ageing society and to cope with the debt dynamics in particular in the Member States facing serious risks to long-term sustainability;

18. Encourages a stronger focus on sustainability in budgetary reforms, as regards both expenditure and revenue measures, preserving sustainable public finance positions and the adequate provision of public services including fiscal discipline and the risks of explicit and implicit contingent liabilities;

19. Welcomes the efforts of the Commission and the Council to improve statistical governance improving the reporting of fiscal data with a recommendation to Member States on EU-wide standards concerning statistical institutes, including principles on professional independence, the confidentiality, reliability, and timeliness of data, and the adequacy of resources of statistical institutes and improved monitoring rights for the Commission;

20. Considers that there is room for improvement in the accounting of public assets and implicit liabilities in order to increase transparency and comparability and to provide a sounder basis for taking decisions; considers that the Commission should launch an initiative in this field;

21. Recommends that the Commission prepare a study on best practices concerning the statistical governance of fiscal data reporting and the accounting of public assets and liabilities in Member States;

22. Encourages the production of national reports on the long-term sustainability of public finances in order to increase awareness and credibility of national commitments and deems that national parliaments should be involved in such an exercise;

23. Stresses the importance for the new Member States' fiscal policies to catch up with average EU income levels and financial development through tax and expenditure policies characterised by efficiency, transparency and reliability and geared towards increased growth, sustainability, and towards both modernising and stabilising the economy;

24. Deplores the lack of policy coordination in the euro zone and draws attention to the divergence in fiscal policies of the Member States in the euro zone and is concerned about possible antagonistic effects of such a lack of coordination;

25. Regrets deficiencies in the current framework of macroeconomic coordination within the ECOFIN Council, as well as the lack of coordination among the Member States; calls on the Commission to carry out a study concerning the economic advantages and limitations of greater economic policy coordination; calls for a more active macro-economic dialogue under the Cologne process between ECOFIN, the ECB and the European social partners;

26. Calls on the Council to adjust the timetable for macroeconomic coordination to enable the Parliament to have sufficient time to submit its contribution;

27. Calls on the Eurogroup chairman to propose a detailed action plan for the duration of his term of office, clearly defining his objectives and planned measures; expects regular reports on the level of implementation achieved;

28. Calls upon the Member States to assume their obligation under Article 99 of the Treaty to regard their economic policies as a matter of common concern and to coordinate those policies; reminds the Member States that better coordinated policies and a better policy mix could improve the aggregate result of their policies; calls for more awareness of the impact of national economic policy at the EU level and of the obligation to consider economic policy of common interest and to coordinate such policy;

29. Instructs its President to forward this resolution to the Commission, the Council, the parliaments of the Member States, and the European social partners.

EXPLANATORY STATEMENT

The Maastricht Treaty makes clear that developments in the public finances in the EU member states should be monitored very closely at the EU level. As public finances have important implications for growth, jobs and macroeconomic stability, and provide crucial context for the functioning of the single currency, they should be considered as a matter of common interest by all EU member states. The Treaty provisions defining requirements for sound and sustainable public finances have been implemented by a number of Council's regulations, and supported by reports by the Commission. The key documents in this respect include, *inter alia*, the Stability and Growth Pact (SGP), with subsequent regulations amending the provisions of the Pact, and Commission's reports with assessments and recommendations addressed to individual member states. The European Parliament evaluates these documents against the backdrop of macroeconomic and budgetary developments in the members states, and adopts its own annual reports on public finances in the EU.

The main message of this year report is that the budgetary situation in most member states remains precarious and that there has been practically no improvement since the last year. While general government deficit in the EU 25 had marginally narrowed from 3% of GDP in 2003 to 2.6% in 2004, and in the Euro area from 3% to 2.7%, respectively, the decline reflected mostly cyclical developments rather than deliberate adjustment policies. Subsequently, amid weak growth the overall deficit has increased in 2005 to 2.7% in the EU 25 and to 2.9% in the Euro area. Since 2003 eleven of the EU member states have deficits exceeding the threshold of 3% of GDP, and since summer 2004 ten EU member countries have been subject to the excessive deficit procedure (EDP) under Article 104 of the Treaty. More importantly, among the countries under the EDP were four largest EU economies: France, Germany, Italy and the UK. The case of Greece is particularly worrying, not only because the country's deficit exceeded 6% of GDP in 2004 and has been highest in the EU, but also because of substantial upwards revisions of Greek fiscal data casting doubts on their reliability. In result, the Council issued a warning notice to Greece under Article 104(9), a last step before sanctions.

One clear symptom of weak enforcement of fiscal rules is the fact that in case of some member states the EDP has been in operation already for several years and yet it has been largely ineffective in helping those member states to bring the budgetary situation into conformity with the provisions of the SGP. This overall situation demonstrates not only that the member states have been unable to reduce fiscal imbalances but also that the SGP corrective mechanisms have not been working properly. The rapporteur expresses serious concern about this persistently lax fiscal stance and the apparent lack of ability to correct the fiscal imbalances in most of EU member states.

As a result of weak growth and a very slow pace of necessary fiscal adjustments the public debt ratios have been systematically increasing, from 61.4% of GDP in 2002 to 64.1% in 2005 in the EU 25, and from 69.2% to 71.7% in the Euro area, respectively. These rising debt ratios pose serious problem for long term budgetary sustainability for the whole EU, especially in the context of increasing long term explicit and implicit liabilities, including pensions. The situation is particularly difficult in some of the most indebted member states (Greece, Italy), where the debt ratios remain above 100% of GDP.

The key underlying reasons for this poor budgetary performance have been persistently weak economic growth in Europe and lack of structural reforms aimed at strengthening public finances in the long term. Economic growth in the EU 25 has slowed down from 2.4% in 2004 to 1.5% in 2005, and in the euro area from 2.1% to 1.3%, respectively. At this rate, the EU grows below potential, and significantly slower than other large economies, such as the US and Japan, as well as China, India and other emerging economies. Behind weak growth has been lack of structural reforms and sluggish domestic demand, reflecting persistent uncertainty about jobs, social protection and pensions among consumers, and about future demand prospects among investors. Fiscal deficits tend to widen under slow growth through its pro-cyclical impact on tax revenues and social security expenditures. High energy prices, instability in oil and gas markets, and massive global imbalances, caused by large twin deficits in the US and reflected by persistent current account surpluses in most of Asian countries, have further eroded business confidence in Europe.

Economic policies in the EU have been unable to overcome these growth barriers. Generally loose fiscal policies have been ineffective in pushing the EU economies onto a higher growth path, because the Keynesian effects of additional final demand under conditions of strong structural rigidities have probably been more than compensated by adverse non-Keynesian effects that have kept investment expenditures at low levels and added to overall uncertainty. Also, the structure of public expenditures has remained broadly unchanged, with only limited resources devoted towards physical and human capital accumulation, innovation and R&D support, and other growth-oriented goals. By contrast, monetary policies have remained restrictive against the background of sluggish GDP growth and the persistently strong euro. The resulting policy-mix has therefore been far from optimal, and maintaining price stability involved higher macroeconomic costs. The rapporteur calls for a more balanced policy-mix, with more disciplined fiscal policy allowing for a less restrictive monetary policy stance.

One important reason for the failure to improve the budgetary situation has been the slow pace of necessary structural reforms. The lack of necessary reforms reduced growth and employment, and put strain on public finances. The EU economies have been suffering from numerous rigidities in the labor and services markets, excessive and costly regulations of business activities, and weak incentives to innovate. The Lisbon Strategy launched in 2000 provided for a comprehensive program for reforms but its actual implementation in individual member states has been hesitant and lags behind the schedule. The rapporteur calls on member states to strengthen efforts aimed at implementing the Lisbon Agenda. To this end, more resources should be spent on enhancing work activity and competitiveness, including measures such as facilitated access to education and life-long learning, flexible rules of employment, support for innovation and reducing red tape for business. The adoption of the Lisbon measures would help to stabilize public finances through its stimulating impact on growth and employment. An important part of this process are pension reforms that help to cope with the adverse budgetary impact of ageing populations and allow to bring the public debt dynamics under control.

Given the generally poor fiscal performance, problems encountered by member states in achieving a close to balance or surplus budgetary position, and weak discipline of enforcement measures implemented within the framework of the SGP, as demonstrated by the large number of on-going EDP cases, the rapporteur calls for more concerted and determined

efforts to increase efficiency of preventive and corrective policy measures to strengthen and consolidate public finances in the EU. The reformed SGP rules are now more realistic, include more incentives to carry out structural reforms and are more oriented towards long-term debt sustainability. They also allow for taking into consideration country-specific factors, such as actual debt levels and structural reforms in progress, which provides a sounder and less controversial basis for assessing fiscal position and policies of individual member states. These revised rules should now be strictly observed and implemented rigorously, with the Commission and the Council taking prompt and transparent decisions *vis-à-vis* the member states that do not comply with the rules. This would help restoring credibility of the SGP, which is necessary if the Pact is to play effectively its disciplining and stabilizing role.

Along with the structural reforms and the improved framework for monitoring and controlling developments in public finances through the SGP, the rapporteur encourages EU member states to cooperate closely and take measures oriented towards improving statistical governance in the budgetary field and quality of fiscal data, establishing common and transparent rules of accounting of public assets and implicit liabilities, and avoiding creative accounting. To avoid overoptimistic budgetary projections, member states should be encouraged to use Commission's forecasts as a common base for revenues and expenditures projections. An alternative solution would be to delegate the task of producing budgetary forecasts to an independent institution.

One important avenue for improving the efficiency of measures aimed at restoring balance in public finances would be to increase public awareness and credibility of national commitments with respect to deficit and debt. To this end, the rapporteur encourages the production of high-level national reports on long-term sustainability of public finances that would highlight risks involved and offer policy alternatives. It would also be useful to consider the advantages of establishing national independent institutions in charge of determining the annual levels of deficit consistent with the medium term objective of balanced budget. These national bodies (Fiscal Policy Committees) would consist of nominated individuals with outstanding professional records who would be politically independent and would be responsible for maintaining fiscal stability in the medium term perspective. Establishing such an institution would allow to take decisions on the size of budget deficit out of the scope of short-term political debates while still leaving the crucial political-economy issues of the level and structure of budgetary revenues and expenditures within the competences of political bodies.

The rapporteur expresses its concern over the lack of necessary coordination among the member states in the field of fiscal policy. Policy coordination is of particular importance in the Euro area where the position of the common currency depends crucially on the fiscal stance in individual member states and where there is a high risk of "free riding". A structural reform undertaken in one Euro area member state brings benefits to the whole area as it strengthens the position of the common currency and reduces long-term interest rates. And *vice versa*, failure to undertake necessary reforms in one or several member states adversely affects other member states through weakening of the single currency and raising interest rates. Policy coordination is therefore needed to obtain important synergies from reforms and avoid antagonistic behavior by member states.

Genuine policy coordination requires political willingness and readiness to take concerted actions. The rapporteur believes that this task can be facilitated by introducing some technical measures that would contribute to establishing a better framework for coordination of fiscal policies at the EU level, including measures such as agreeing on a uniform timetable for budgetary procedures across the member states, encouraging member states to prepare budgets on biannual basis and using cyclically-adjusted deficit concept in national budgetary procedures. The rapporteur calls upon the Commission to undertake an impact assessment study on economic gains and benefits of a real coordination of fiscal policies across the EU and the opportunity cost to the EU of non-coordination.

The rapporteur stresses that sound fiscal policies are of particular importance in the new member states in the process of catching up toward average EU levels of income and welfare. Given the generally lower level of national savings in most of new member states, budget deficit-to-GDP ratios of size similar to those observed in EU 15 leave proportionally less resources for private investment and negatively affect growth. This calls for continuation of fiscal and structural reforms to ensure that growth rates in the new member states are high enough to allow for real and nominal convergence with the rest of the EU.

The rapporteur stresses the importance of sound and sustainable public finances for achieving higher growth and more jobs in the EU. The rapporteur calls upon the member states to assume their obligation under Article 99 of the EC Treaty to regard their economic policies as a matter of common concern and to better coordinate these policies. The Parliament is determined to play an important and constructive role in this process, in line with its competences and prerogatives.

PROCEDURE

Title	Public finances in Economic and monetary Union (EMU)
Procedure number	2005/2166(INI)
Committee responsible Date authorisation announced in plenary	ECON 29.9.2005
Committee(s) asked for opinion(s) Date announced in plenary	BUDG 29.9.2005
Not delivering opinion(s) Date of decision	BUDG 15.3.2006
Enhanced cooperation Date announced in plenary	
Rapporteur(s) Date appointed	Dariusz Rosati 4.7.2005
Previous rapporteur(s)	
Discussed in committee	28.11.2005 20.3.2005 25.4.2005
Date adopted	25.4.2005
Result of final vote	+ 37 - 2 0 1
Members present for the final vote	Zsolt László Becsey, Pervenche Berès, Sharon Bowles, Udo Bullmann, Ieke van den Burg, David Casa, Jan Christian Ehler, Elisa Ferreira, Jean-Paul Gauzès, Robert Goebbels, Karsten Friedrich Hoppenstedt, Sophia in 't Veld, Othmar Karas, Wolf Klinz, Christoph Konrad, Guntars Krasts, Kurt Joachim Lauk, Astrid Lulling, Gay Mitchell, Cristobal Montoro Romero, Joseph Muscat, John Purvis, Alexander Radwan, Bernhard Rapkay, Dariusz Rosati, Eoin Ryan, Peter Skinner, Margarita Starkevičiūtė, Ivo Strejček, Sahra Wagenknecht, John Whittaker
Substitute(s) present for the final vote	Jorgo Chatzimarkakis, Harald Ettl, Satu Hassi, Ján Hudacký, Werner Langen, Jules Maaten, Thomas Mann, Corien Wortmann-Kool
Substitute(s) under Rule 178(2) present for the final vote	Íñigo Méndez de Vigo
Date tabled	4.5.2006
Comments **(available in one language only)**	