Public finances in EMU 2007 and 2008

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The Committee on Economic and Monetary Affairs adopted an own initiative report by Donata **GOTTARDI** (PES, IT) on public finances in the EMU 2007-2008.

The report tackles the following main aspects:

Changes in economic trends during 2007 to 2008 - the economic and financial crisis and outlook: the Committee on Economic and Monetary Affairs expresses its concern at the difficult economic and financial situation currently affecting Europe and the world, which is creating an unprecedented level of instability. The report notes that, in the face of market failures and a lack of rules and supervision, **public sector intervention is reassuming a pivotal role**, sometimes taking the form of outright nationalisation.

MEPs call on the Commission and the Member States to **provide for an appropriate assessment of the repercussions for public finances of public sector support and participation in major industries and the financial and credit sector**. They highlight the need to ensure that every intervention and use of public funds for rescuing financial organisations is accompanied by **appropriate supervision**, concrete improvements in the governance and business conduct of the enterprise or institution, precise limits on the amounts paid to executives and clear accountability vis à vis the public authorities. They also recall the importance of a coordinated approach at European level to combat tax evasion and tax havens.

Given that the wholesale public sector intervention in several Member States to rescue and support the banking and finance industry will have clear repercussions for public finances and personal incomes, MEPs consider it necessary for the **tax burden to be equitably spread among all taxpayers**. This entails, on the one hand, the imposition of an appropriate level of taxation on all financial players and on the other, provision for a gradual and sharp reduction in the tax burden on mid to low level salaries and pensions, in such a way as to reduce poverty and to promote consumption and a growth in demand, thereby responding to the current economic crisis which presages a recession.

MEPs stress that **European macro economic policies must provide a swift and coordinated response** to the risks of recession and financial instability, and urge the Commission and the Member States – and particularly those of the Euro area - to make intelligent and unidirectional use of the flexibility in the Stability Pact and suitable counter cyclical mechanisms aimed at structural change, efficient allocation of public funds, restructuring of public expenditure and investments for growth, devoting special attention to the role of small and medium-sized enterprises. In this context, MEPs emphasise the need for a **common approach on wage policies**, which provides for wage increases in line with actual inflation and productivity.

MEPs emphasise that the revised Stability Pact already allows for action to be taken in response to particularly serious situations and that financial consolidation and the objectives set in the stability and convergence plans remain fundamental to the prospects for recovery and growth. They also consider that it would be useful to establish a **compulsory mechanism for consultation and coordination** between the Commission and the Member States –particularly members of the Euro Group – prior to the adoption of major economic measures, in particular as regards measures addressing the volatility of prices for energy, raw materials and foodstuffs.

The sustainability of public finances and the effectiveness of the preventive arm of the Stability and Growth Pact (SGP): MEPs express their deep concern over the direct consequences of the current international financial crisis on the sustainability and quality of public finances in the Member States. They point out that **deficit and public debt are having a negative impact on growth**.

MEPs note that the revised SGP is functioning properly. They consider that the corrective arm has been applied in a satisfactory manner in previous years and stress the **importance of the preventive arm** as a vital instrument in respect of the sustainability and convergence of the financial policies of Member States, in particular those in the Euro area. Moreover, they stress the **importance of the medium-term objective** (MTO) as a specific budgetary target hitched to economic, fiscal and incomes policies, which should be achieved through macro economic dialogue, geared to the specific situation in each Member State and determined on a multiannual basis. Member States are urged to strengthen the credibility and legitimacy of the MTO both at national and local level, by establishing regional SGPs and MTOs.

The report stresses the importance of designing **macroeconomic plans for tackling external shocks** (such as the subprime financial crisis) that take into account not only the situation in the Euro area, but also that in the catching-up economies of the European Union.

Public finances - a key feature of a broader and more comprehensive economic approach: the report stresses that public finance objectives, established on the basis of the integrated guidelines in the new Lisbon cycle, should link up stability and convergence plans with national reform plans in a coherent and organic manner. MEPs believe that the added value of healthy and growth-oriented European public finances should be reflected – in particular in the Euro area - in a **European public infrastructure investments policy**, formulated and coordinated on the basis of shared objectives, that can be funded not only from national budgets and (partially) the EU budget, but also from new European financial instruments (e.g. Eurobond or the European Investment Fund) aimed at sustaining the growth, productivity and competitiveness of the European Union and the Euro area in the international context.

MEPs considers that it would be useful: (i) to establish a **compulsory mechanism for consultation of the national parliaments**, alongside the European Parliament, with an eye on the coordinated development of stability and convergence programmes, and of national reform programmes, in such a way that these are linked and presented together, possibly in the autumn of each year; (ii) to adopt a **new approach to public finances** which is systematic and coordinated among the Member States, and in particular those of the Euro area, and which aims to support long term economic growth.

The quality of public finances: revenue and expenditure: MEPs consider it essential that the Member States seek to implement **QPF policies that are convergent** and based on a method of assessment that includes indicators and objectives, the formulation and definition of which should involve the European Parliament and the national parliaments. They urge the Member States to adopt QPF policies together with a system for assessing budgetary policies – such as performance based budgeting (PBB) (based on the OECD model) – aimed at improving the quality of public spending by strengthening the link between the allocation of resources and results.

The report advocates a **system for assessing budgetary policies** that focuses on specific aspects such as composition, efficiency and effectiveness of public expenditure, the structure and effectiveness of revenue systems, the efficiency and quality of public administration, sound budgetary management and a method for coordinating quality public finance policies among Member States. It calls for a greater comparability of national budgets in order to meet the above objectives.

While MEPs acknowledge the difficulty of devising a homogeneous reform of taxation leading to greater growth, they stress, however, that a number of **common tax reform measures** could significantly improve the efficiency of the tax system and tax revenue, increase employment, reduce distortions and

increase growth at European level, notably, inter alia: (i) introducing a broader tax base (and lower rates) in order to reduce distortions and increase revenues; (ii) reducing tax pressure on work through a fairer allocation of the tax burden among the various categories of taxpayers; (iii) a reorganisation of incentive and tax relief schemes.

The report draws attention to the core issue of the **composition of public expenditure** aimed at sustainable growth and stresses that public expenditure should be reorganised by reallocating budget items to growth-enhancing sectors, using public resources more effectively and efficiently and providing for an appropriate integrated public-private network. They also point to the need to **reform and modernise public administrations**, to ensure that they meet criteria relating to effectiveness. In the light of the above, the Commission and the Member States are called upon to set up a **coordination mechanism to monitor and assess** the quality of Member States' budgetary policies, based on systematic quality reporting, QPF assessment through a PBB system and periodic reviews of QPF.