Public finances in EMU 2007 and 2008

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The European Parliament adopted by 521 votes to 47 with 55 abstentions, a resolution on public finances in the EMU 2007-2008 in response to the Commission Communication on Public Finances in EMU - 2007 – Ensuring the effectiveness of the preventive arm of the Stability and Growth Pact (SGP).

The own-initiative report had been tabled for consideration in plenary by Donata **GOTTARDI** (PES, IT) on behalf of the Committee on Economic and Monetary Affairs.

The resolution tackles the following main aspects:

Consequences of the economic and financial crisis: Parliament expresses its concern at the difficult economic and financial situation currently affecting Europe and the world, which is creating an unprecedented level of instability. 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 invite 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. The Commission should promote the introduction of guidelines to ensure a consistent and coordinated implementation of the various national action plans.

Tax burdens, 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. The resolution points to the importance of a coordinated approach at Community level to combat tax evasion and tax havens.

Exploit the flexibility offered by the SGP: 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.

Compulsory mechanism for consultation and coordination: 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.

Sustainability of public finances: MEPs considers the sustainability of public finances to be a pre-condition and priority not only for stability and growth and the formulation of each Member State's macro-economic employment, social and environmental policies, but also for the future of the economy and the European social model intrinsic to the development of the European Union. They 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.

More targeted use of the SGP: MEPs 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. Member States are urged to make greater efforts to consolidate their budgets and reduce the public debt during periods of growth as a pre-condition for achieving a healthy, competitive and sustainable European economy.

In the light of new international circumstances due to the present financial crisis and the economic slump which has already begun to affect employment and growth in the euro area, MEPs state that rising deficits are difficult to avoid. They suggest, therefore, that Member States make more targeted use of the flexibility provided by the SGP in order to encourage economic recovery and growth. The Commission is called upon to examine the effects of the SGP criteria in the current context.

The resolution 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 finance objectives: Parliament stresses that public finance objectives 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. The importance of employment and social inclusion policies are also highlighted.

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 (QPF): 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.

The resolution 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. It also points to the need to reform and modernise public administrations, to ensure that they meet criteria relating to effectiveness.

Tax reform measures: 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. 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.