Long-term sustainability of public finances for a recovering economy

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The Committee on Economic and Monetary Affairs adopted the own-initiative report drawn up by Liem HOANG NGOC (S&D, FR) on the long-term sustainability of public finances for a recovering economy in response to the Commission communication on the subject (COM(2009)0545).

The committee expresses deep **concern about the long-term sustainability of public finances in the aftermath of the financial and economic crises**, recalling that the efforts made in the framework of the Stability and Growth Pact (SPG) prior to the crises were to a very high degree geared towards meeting the growing demographic challenge. Much of this effort has been wiped out by the need dramatically to increase government expenditure in order to prevent the worldwide meltdown of the financial system and to alleviate the social consequences of this meltdown. The committee deplores the fact that, even before the crises started, a number of Member States' performances in consolidating their public finances were not impressive despite the fact that economic conditions were favourable. It stresses that the **SPG must aim for balance or surplus over time**, requiring surplus in economic good times and pension schemes transparently financed in the framework of public budgets or by funded private schemes. They call, in this connection, for the better implementation of the preventive arm of the SGP.

Members stress that **high debt and deficit levels are a threat to sustainability** and will have adverse effects on public health care, pensions and employment. They warn against using the crisis as a pretext not to consolidate public finances, not to decrease public spending and not to implement structural reforms. They emphasise that the role of social protection systems as '**social safety nets**' has proven particularly effective in times of crisis; underlines that stable public finances are a precondition for ensuring that this is also the case in the future.

Members are deeply concerned that many Member States are in breach of the SGP, and agree with the Commission statement that debt sustainability should be given **a very prominent role in surveillance procedures**. They urge the Commission rigorously to ensure compliance with the SGP. Whilst pointing to the need to consolidate public finances and reduce deficit and debt levels, the report warns against an abrupt ending of support to the real economy, in order to avoid a double dip. It welcomes the Commission's work on the exit strategy from the present contingency measures, and supports the Commission's approach based on **exit strategies that are differentiated** between countries in time and scope. The **fiscal exit strategy should be launched before the monetary exit strategy** in order to allow the latter to be correctly implemented, thus ensuring that the ECB, which successfully avoided a slip into deflation, can equally well ensure that inflation does not ruin the recovery. Members note that a controlled exit from the deficits is of crucial importance **to keep interest rates down and the debt burden limited**.

In view of the demographic challenges, Members call on the Commission to draw up a **Green Paper on the birth rate in the EU** in order to identify the causes and implications of the falling birth rate, as well as solutions and alternatives regarding this problem. The report notes that demographic changes, and the ageing of the population, in particular, mean that **state pension schemes in many Member States will have to be reformed from time to time**, especially as regards the contributive base, so as to keep them financially sustainable.

Members go on to acknowledge that the SGP is **not a sufficient tool for harmonising the fiscal and economic policies** of the Member States, and therefore support a review of the mechanisms needed to bring the national economies within the EU back on a convergence track. They suggest that the

Commission should draw up an appropriate mechanism for cooperation with the IMF in special cases where Member States receive balance-of-payments support from the latter.

The committee points out that rising deficits make borrowing more expensive, partly due to the fact that markets assess risks as more serious when the debt burden is increasing faster than economic growth and the ability to pay back loans. It stresses that the current financial crisis has emphasised the direct link between financial market stability and the sustainability of public finances, and emphasises the need for **strengthened supervisory legislation on financial markets** that include strong mechanisms for consumer and investor protection.

The report asks the Commission to carry out studies to assess the **quality of the Member States' debts**. It suggests, in particular, that the Commission assess the effects of the **fiscal spending** deployed by the Member States in order to kick-start their economies, in terms of its impact on production, on government accounts and in stimulating and protecting employment, both in the short and long term. The **structural deficit** should be one of the indicators used in determining the long-term sustainability of public finances. Members call on the Commission to consider the **reduction of long-term sustainability gaps** in public finances as an essential part of the EU's 2020 strategy. They call on Member States, after plugging their sustainability gaps, to reduce their **public debt-to-GDP ratio to a maximum of 60%**.

Members move on to stress that recent **speculative attacks** against several European economies had as their primary target the euro itself and European economic convergence. In that sense, they are convinced that European problems need European solutions, which should offer internal means of avoiding any risk of defaults by combining national fiscal discipline with last-resort mechanisms of financial support. They also state they are extremely worried about the disparities in the **quality of statistics** that can be observed in the EU in general and in the eurozone in particular.

The report highlights the **very positive role of the EU budget**, albeit much limited by the MFF, in mitigating the effects of the crisis through the financing of the European Recovery Plan and the redeployment of funds towards priority areas. It deplores, however, the **lack of adequate coordination between Member States' economic and fiscal policies** to combat the economic and financial crisis as well as to ensure the long-term sustainability of public finances.

The social and employment dimension of the crisis exit strategy: Members note the need for the Member States to consolidate their accounts and improve the liquidity of public finance in order to lower the cost of debt, but also the need for this to be done in a balanced way and within a reasonable time frame. Indiscriminate cuts in public investment, research, education and development will have a negative impact on prospects for growth, employment and social inclusion. Long-term investment in these areas must continue to be promoted, and where necessary expanded. The committee regards it as essential to assess properly the social and employment-related effects of the crisis and to formulate at EU level a recovery strategy based on support for employment, training, investments that lead to the boosting of business competitiveness and productivity, especially for SMEs, and the revitalisation of industry. These objectives should be at the heart of the Europe 2020 strategy.

The impact of demographic change and the employment strategy: the sustainability of public finances depends largely on the ability to raise employment levels to meet demographic and budget-related challenges, with particular reference to the sustainability of pension schemes. Members consider that existing European human capital can be supported in the medium term by **appropriate migration policies** leading to the integration of migrants into the labour market and the award of citizenship. They also consider that the Europe 2020 strategy should take the form of a '**pact on economic, employment and social policy**' aimed at sustaining the competitiveness of the European economy and focused on labour market integration for all. The strategy should be based on guidelines, and where possible indicators and

benchmarks that are comparable both nationally and at EU level, backed up by bonus mechanisms for those who meet the targets and corrective mechanisms for those who do not, respecting flexicurity principles and the social dialogue method.

The sustainability of social protection systems: the report stresses the importance of the imminent Green Paper on pension reform. It considers that the **development of sustainable, well-diversified pension systems** with different sources of financing which are linked to labour-market performance or the financial markets and could take the form of company schemes, and which involve public, supplementary employer-based and individual schemes, is vital and should be encouraged contractually and fiscally. It recognises the importance of pension literacy among EU citizens.