2007 annual report on the euro area

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The Committee on Economic and Monetary Affairs adopted the initiative report by Dariusz **ROSATI** (PES, PL) on the 2007 annual report on the euro area. The salient issues covered by this report are as follows:

Macroeconomic developments: it welcomes the favourable economic developments achieved in 2006 in terms of growth and employment, resulting in the creation of 2 million new jobs and lower fiscal deficits. It points out that the high unemployment levels and the low participation in labour markets do not allow Europe to respond successfully to current and future challenges in a global economy.

Part of the recovery is driven by structural improvements and the committee welcomes the fact that labour productivity is increasing at a higher rate. It considers, however, that it is too early to draw firm conclusions as to whether the recovery is more cyclical or more structural in nature. Therefore, it calls for a cautious stance in this regard.

It insists that sound fiscal policy is a pre-condition for sustained growth and job creation since low budget deficits and government debt foster low and stable inflationary expectations and help maintain low interest rates. It warns against repeating the policy mistakes of 1999-2001 and therefore calls for the current upswing to be used in two ways in order to achieve the following: to eliminate deficits and accumulate surpluses, which would reduce debt levels as well as to improve the quality of public finance by investing more in education, vocational training, infrastructure, and research and innovation, which would assist in helping to meet the challenges posed by an ageing population.

The risks posed by pro-cyclical policies in some Member States are stressed. The reformed Stability and Growth Pact explicitly requires fiscal consolidation over the economic cycle. The committee notes that procedural or numerical fiscal rules and independent fiscal institutions support fiscal consolidation

and help avoid pro-cyclical policies. The committee emphasises the need to take into account the effects that future increases of interest rates may have on the euro exchange rate and the competitiveness of the European economy.

Functioning of the EMU: MEPs consider that diverging trends in growth, inflation, real exchange rates and employment among Member States may reflect different developments, e.g. demographic trends, different rates of progress as regards the structural reforms, varying growth potentials and catching-up processes. They underline however that large current account deficit in some Member States are symptoms of diverging trends in competitiveness and that the different approaches of economic policy among Members States are key to explaining such differences. They observe that differences in the level of international competitiveness of euro area economies are partly caused by diverging trends in unit labour costs which reflect different developments in productivity and wage dynamics. They call on shareholders and corporate executives to maintain a responsible policy towards remuneration packages and bonuses at the top corporate levels, which tend to grow disproportionately compared to ordinary salary levels, and thus give the wrong signals and discourage support for a responsible wage policy. It is noted that low inflation rates are also an important influencing factor as regards the favourable development of unit labour costs.

The committee calls in this connection for a further integration of the market in goods and services in order to overcome the existing fragmentation of the EMU market into national markets and to achieve a higher level of synchronisation between the economic cycles of the participant economies. It notes that the

euro can only retain its long-term strength and credibility on the international financial markets if there is a further rapprochement between the Member States of the euro zone in all areas relevant to monetary stability and urges the Member States of the euro zone, and the social partners in particular, to make greater efforts in this respect, as well as to improve trends in productivity, a factor which is also important in achieving the Lisbon Strategy objectives.

It observes that loose fiscal policies combined with restrictive monetary policy driven by interest rate increases and exchange rate appreciation result in a suboptimal policy mix which may entail excessive macroeconomic costs of stabilisation. It considers that more fiscal tightening would reduce pressure on monetary policy and allow for a better policy mix that would ensure faster economic growth under a given inflation rate.

Structural reforms and the internal market: the committee recalls that an integrated European financial market is essential to ensuring the smooth functioning of the EMU. It dwells, therefore, on the need to complete financial market integration and to remove the remaining obstacles to financial integration in order to create an efficient financial system and improve the euro area's capability to deal with economic shocks. It draws attention to the fact that financial integration may also pose a risk to financial stability if the procedures for crisis prevention, management and resolution remain segmented at national level, making area-wide responses more difficult; reasserts, therefore, in this context the need for an integrated European system of cooperating supervisors as one key element as regards the completion of financial market integration.

The committee calls for a consistent policy which fosters innovation-based growth. It recalls that such a policy requires more investment in infrastructure, research, innovation, lifelong learning and education, more competition on product and services markets, more developed financial sectors and more flexible labour markets while ensuring the required level of social security (flexicurity) in accordance with the renewed Lisbon Strategy, as well as complementary policies aimed at correcting excessive inequalities caused by the reforms.

Enlargement of the euro area: the report welcomes the entry of Slovenia to the euro area on 1 January 2007 and the smooth changeover from the Tolar to the euro. It encourages other new Member States to continue efforts to prepare themselves for entry into the euro area and highlights the benefits stemming from the convergence process and the final adoption of the euro, both for the new Member States and for the euro area as a whole. It considers that issues relating to the euro area should not be focused exclusively on the new Member States and points to the issue of opt outs. There is a need for agreement between Parliament, the Council and the Commission on a clear roadmap for the euro area application procedure in order to ensure a sufficient period of assessment and preparation for all institutions involved, which would increase the confidence of citizens and Member States in the changeover process.

It calls for more effective action to tackle money laundering and fraud and questions the lack of information in the Commission’s regular reports on offshore companies or on their role and importance and requests information on this subject.

MEPs considers that the new Member States may face challenges in joining the euro area especially with regard to the price stability criterion, since inflation may be part of the catching-up process. Therefore, they call on the Council and the Commission to examine the convergence criteria through further analysis of and policy debate on the application of the convergence criteria to prospective new members of the euro area and in the light of the new reality and differences in economic developments.

Governance: MEPs consider it crucial to achieve a better coordination of budgetary policies among Member States over the cycle, notably based on a common calendar and macroeconomic assumptions. They call for the strict and effective implementation of the Stability and Growth Pact. They consider that the specific euro area dimension of structural surveillance associated with the Lisbon Strategy should be

strengthened by including measures that are needed to improve the functioning of the EMU. They welcome, as a first step in this direction, the focus on the euro area in the Commission's Annual Progress Report on the state of implementation of the Lisbon Strategy.

The need to strengthen governance is stressed as well as the process of European integration, in particular within the euro area, as this is the only way to tackle global economic challenges. The Council and the Commission are called upon to ensure, in the future, that the annual report on the euro area delivers a set of policy recommendations providing instruments for a detailed dialogue between the various Community bodies that are involved in strengthening the economic governance of the Union. They believe that the Eurogroup should agree on a roadmap on what should be achieved in the next two years in the euro area.

External representation: the committee emphasises that the euro has emerged as the second most important international currency behind the US dollar. It considers that the wide use of the euro in international bond markets is a key feature of the euro's international role. It regrets, however, that the Eurogroup president, the Commission and the ECB continue to be represented to very different extents in the various international institutions and fora. It considers that further steps are needed before the external representation of the euro area is commensurate with its growing importance in the global economy. A prerequisite for common external representation is the existence of a genuine common economic policy within the euro area and the committee reasserts that the best option for representation of the euro area in the major international financial fora and institutions remains the creation of a single euro area chair.