



Procedure file

| Basic information | | |
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| Report on the 2009 annual statement on the euro area and public finances | | |
| Subject | | |
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| Key players | | | |
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| European Parliament | Committee responsible | Rapporteur | Appointed |
| | ECON Economic and Monetary Affairs | | 21/07/2009 |
| | | Vers/ALE GIEGOLD Sven | |
| European Commission | Commission DG | Commissioner | |
| | Economic and Financial Affairs | REHN Olli | |

| Key events | | | |
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| 26/11/2009 | Committee referral announced in Parliament | | |
| 23/02/2010 | Vote in committee | | Summary |
| 04/03/2010 | Committee report tabled for plenary | A7-0031/2010 | |
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| 25/03/2010 | Debate in Parliament |  | |
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Documentation gateway

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|---|--|-------------------------------|------------|----|---------|
| Document attached to the procedure | | SEC(2009)1120 | 12/08/2009 | EC | Summary |
| Non-legislative basic document | | COM(2009)0527 | 07/10/2009 | EC | Summary |
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Report on the 2009 annual statement on the euro area and public finances

This Commission Staff Working Document gives an overview of public finances in the EMU for 2009.

In particular, it outlines recent developments and medium-term prospects for the 27 Member States.

Report on the 2009 annual statement on the euro area and public finances

The Commission presents its Annual Statement on the Euro Area 2009.

1) The European Area Economy in 2009: the report states that in the wake of the shockwaves of the worst crisis since the 30s, signs of economic stabilisation are emerging. Important policy interventions have succeeded in achieving a degree of stability in the financial system. Financial conditions have improved over the summer, with several financial indicators returning to pre-crisis levels. Growth in the euro area is set to fall by 4% in 2009, unchanged from the Spring 2009 forecast. The stronger than expected contraction in activity in the first quarter was compensated for by a faster than projected stabilisation in the second quarter, especially in Germany and France.

However, the strength and resilience of the recovery has yet to be fully tested. While banks are in the process of strengthening their solvency ratios, the stabilisation in financial markets has yet to yield concrete outcomes for credit distribution to the economy, which has decelerated considerably throughout the first half of 2009.

The euro has acted as a valuable shield in the crisis, by protecting the euro area from the exchange rate and interest rate turbulence that had proved so damaging for Member States in episodes of financial market stress in the past. The financial crisis has increased the attractiveness of the euro for non-euro area Member States, eliminating the risk of sudden and disruptive exchange rate movements, but has also shown that the euro does not solve challenges related to internal and external imbalances. This experience confirms the rationale for achieving a high level of sustainable convergence prior to euro adoption.

The crisis is amplifying some challenges in the euro area, weighing on the sustainability of public finances and potential growth. As a consequence of the steep fall in revenues, fiscal stimulus measures under the European Economic Recovery Plan (EERP) and the operation of automatic stabilisers, government balances have deteriorated sharply. The average euro area budget deficit is now expected to increase from 2% of GDP in 2008 to over 5% of GDP in 2009. Almost all euro area Member States will post budget deficit ratios above the 3%-of-GDP threshold, with some countries exceeding the benchmark by a large margin.

2) Imbalances accumulated in the past rendered some euro area Member States more vulnerable when crisis struck. At a global level, the speed and intensity of the contagion from the Lehman Brothers bankruptcy came as a surprise. While the global, interconnected nature of the banking and financial system largely accounts for the contagion, the difficulties experienced by some Member States have underscored a number of vulnerabilities within the euro area itself.

Accumulated intra-euro area imbalances exposed some economies, more than others, to shocks. From a balanced position in 1999, surpluses steadily accumulated and reached 7.7% of GDP in 2007, while aggregated deficits rose from 3.5% of GDP in 1999 to 9.7% in 2007.

In countries in deficit, the divergence trend reflected the build-up of domestic imbalances. They materialised through excessive domestic demand pressures, a surge in house prices and a bloated construction sector. This was especially patent in Ireland, Spain and Greece, which consistently recorded higher growth and inflation than the rest of the euro area during the decade. Conversely, countries in surplus capitalised on their traditional strengths, with a growth model centred on their already-competitive export sector. In these countries the engine of domestic demand never really kicked in to take over the export engine. The impact of the crisis revealed the vulnerability of this growth model to fluctuations in global demand, with implications for growth in the euro area as a whole.

Another source of imbalances lay in the rapid growth of the financial sector. Ireland has been a textbook case and following the crisis, ballooning impaired assets weakened the banking sector and put public authorities, acting as the lender of last resort, under pressure.

Such imbalances explain why the crisis has hit some Member States harder than others. Overall, Member States pursuing unbalanced growth models have suffered particularly severe economic contractions. The impact of the crisis demonstrates the need for action. Policymakers in Member States largely ignored these imbalances in good economic times. They should not be ignored any longer.

3) Unfinished business also hampered the euro area's capacity to respond to the crisis: deeper financial integration in the euro area was not matched by a parallel strengthening of supervisory arrangements. The Commission has acted effectively to fill this gap. It provided a common framework for the implementation of national banking rescue plans, in line with state aid rules, benefiting also from ECB support. While the fiscal house was mostly in order when the crisis struck, some Member States had limited room to respond to the crisis. Public debt levels remained high in Greece, Italy and Belgium, while fiscal consolidation was slow and indecisive in France, Greece and Portugal. In other countries, public finances became dependant on fiscal revenues either from the financial sector or the real estate boom whose slump added to the deterioration of public finances and greatly diminished the fiscal room for manoeuvre available to counteract the effects of the crisis. Globally, euro area governments did their fair share in the concerted global effort to sustain demand within the EU-wide coordinating framework of the EERP. The overall fiscal support amounts to about 4.6% of euro area GDP (about 5% for the EU as a whole).

The aggregate impact of the euro area economic policy response could have been faster and perhaps stronger if co-ordination had started earlier and been more comprehensive.

4) The way forward: ensuring efficient internal adjustment and sustainable growth in a challenging environment. The crisis has clearly demonstrated the urgency for euro area Member States to make rapid progress on the EMU@10 reform agenda: broadening and deepening macroeconomic surveillance. In its [EMU@10 communication](#) in May 2008, the Commission proposed a three-pillar agenda to improve the functioning of EMU in the face of a rapidly changing global environment, ageing populations and rising concerns about energy and climate change.

It also called for the deepening of fiscal policy coordination and increased surveillance.

Broader macroeconomic surveillance is urgently needed to spur a co-ordinated policy response to the competitiveness challenge. The broadening of surveillance should also incorporate financial market developments in earnest.

Surveillance should be deepened to ensure sustainable public finances. In the wake of the crisis, the combination of low growth and accelerating debt risks putting public finances in a precarious situation, just when the impact of ageing is starting to set in. If policies are unchanged, public debt in the euro area is projected to reach 100% of GDP in 2014. As part of a deeper fiscal co-ordination in the euro area, a firm commitment is needed for a fiscal strategy that can appropriately balance stabilisation and sustainability considerations in line with the Stability and Growth Pact.

Co-ordination across policies and Member States should be enhanced to permit judicious exit strategies. Differentiated policy responses will need to be incorporated in national exit strategies so as to achieve the best global output. In line with the Council recommendations to the euro area in the context of the Lisbon strategy, progress is needed on the implementation of reforms that enhance potential growth and facilitate adjustment to shocks.

The crisis underscored the need to reinforce the framework for euro area surveillance and governance. The Lisbon Treaty provides the necessary platform for the further improvement of economic governance of the euro area. Highlighting the need to develop ever-closer co-ordination of economic policies within the euro area, a new Protocol attached to the Lisbon Treaty gives formal recognition to the Eurogroup and its President. The Lisbon Treaty also strengthens the role of the Commission in the surveillance of the functioning of EMU.

Lastly, the Commission considers that united, the euro area can influence the global agenda. The emergence of the G20 as the forum of choice for the promotion of global economic and financial governance reform raises the stakes for the euro area. In this context, the euro area should be considered as a single economic entity, which will continue to grow in importance as new members progressively join. For the euro area to speak with a strong voice at the global level, the EU external representation, particularly within the IMF, needs to be strengthened. Now is the moment, while discussions on quota and representation reform are gaining momentum.

Report on the 2009 annual statement on the euro area and public finances

The Committee on Economic and Monetary Affairs adopted the own-initiative report drawn up by Sven GIEGOLD (Greens/ALE, DE) on the Report on the 2009 Annual Statement on the Euro Area and Public Finances.

Monetary policy: Members are alarmed by the ongoing contraction of employment in the EU despite the exceptional efforts of monetary and fiscal policy. They stress that, in addition to the exceptional recovery measures, structural reforms must be stepped up rather than stalled, so as to make the European economy and labour market more robust. They welcome the ECB's extension of liquidity to credit institutions; but are concerned that the extra liquidity has not been used by all banks to ease the 'credit crunch' faced particularly by small and medium-sized businesses (SMEs).

The committee is also concerned about the economic consequences for the euro area of a rapid fall in the value of the US dollar and the renminbi yuan, the latter artificially devalued by an unfair intervention on the part of the Chinese Government, and the possibility of a new asset bubble in Asia. It calls for enhanced international macroeconomic dialogues in order to adjust exchange rates so that a more balanced world economy may be achieved.

The report underlines the fact that the discipline of wage moderation also acts as a brake on the growth of household income and therefore warns against focusing exclusively on wage moderation as an instrument to achieve price stability. It recalls that increased global competition has already contributed to downward pressure on wages, while higher commodity prices and energy costs have reduced the purchasing power of EU consumers. Members stress that real salaries should rise in line with productivity gains, in order to guarantee long-term stability in the distribution of income.

Members feel that exchange-rate fluctuations constitute an impediment to global economic recovery and that coordination of monetary policy is essential to avoid the emergence of financial imbalances. They call for a world monetary conference to be organised under the auspices of the IMF, and they also want better coordination between the WTO, the IMF, the Financial Stability Board and the World Bank Group in order to combat speculation.

Improving coordination and cooperation on economic policy: the Committee shares the Commission's concerns about accumulated imbalances in the euro area. It calls on the Commission to develop diagnostic tools and indicators, in order more effectively to assess economic developments in Member States, including multilateral surveillance of unit labour costs, real exchange rates, financial markets and

policies affecting competitiveness. It also suggests that the Commission examine possible ways of improving effectively the economic governance of the euro area, including the setting-up of new mechanisms to prevent the renewed excessive growth of such imbalances in the future and the asymmetric shocks to which they contribute.

Members also make the following points:

- the established mechanism of policy coordination within the euro area did not work well in the crisis, and they share the Commission's view that a deepening and broadening of macroeconomic surveillance is urgently needed;
- they warn against excessive recourse to the EIB, which would result in the budgetary procedure being circumvented and would prevent Parliament from giving its opinion on the trajectory of committed expenditure;
- they stress the need for comprehensive application of the rules of the SGP while noting that the rules laid down in the SGP refer only to public deficit and public debt. They consider that fiscal coordination should go beyond the current scope of the SGP;
- economic coordination should take the form of an integrated European economic and employment strategy on the basis of the forthcoming EU 2020 Strategy, the Integrated Guidelines, the Sustainable Development Strategy and the convergence and stability programmes.

Public finances: noting that Member States' public deficits are set to increase rapidly to about 7% of GDP in 2010, the committee expresses its deep concern over the unsustainable level of public debt and its predicted rapid increase in 2010 and 2011. It takes the view that, once out of the current recession, there is a need, while complying with the reformed SGP, to strengthen the preventive arm of the pact in order to ensure that Member States refrain effectively from pro-cyclical policies during periods of growth. Members support the Commission's use of the excessive deficit procedure in order to reduce public deficit and emphasise the importance of quantifiable programmes for balancing the public finances in Member States, starting in the years 2010 and 2011. They are extremely concerned at developments in the deficit situation in Greece, and call for lessons to be learnt from this situation, in future enlargements of the euro area, especially in relation to the quality of statistical data.

The report states that Member States with difficulties in sustaining their public finances should, in the first instance, be responsible for resolving those difficulties, particularly by means of a more appropriate fiscal policy, and it calls on Member States to accelerate the pace of their reforms through determined policy actions. Members also regret that there are no binding commitments among governments to enforce coordination in the euro area.

They call on the Commission to propose a set of measures to help Member States restore balance in their public accounts and finance public investment through:

- eurobonds or similar measures in order to lower the cost of interest for servicing public debt,
- encouraging tax cooperation between Member States including a timetable for the introduction of a common consolidated corporate tax base;
- introducing country-by-country reporting on corporate income and the taxes paid thereon.

The committee calls on the Commission:

- to work towards the definition of tools to enhance the comparability of national budgets as regards spending in different categories;
- to make a concrete proposal as soon as possible as to how the financial sector should contribute to the cost of the crisis;
- with the ECB and euro Member States, to encourage the process of economic and monetary integration within the EU and to support enlargement of the euro area.

Lastly, the committee stresses the importance of using effectively the new provisions in Article 136 of the TFEU to improve economic coordination and governance in the euro area, and it looks forward to concrete proposals in this respect.

Tackling resource dependency: stressing that delaying action on climate change because of the crisis could be costly in both economic and environmental terms, the committee calls for radically increased efforts in this direction. It calls on the Eurogroup to take the necessary measures to facilitate an entry into the euro area for those Member States which are seeking to join and which fulfil the conditions for entry.

External representation of the euro area: Members regret the lack of progress in improving external representation of the euro area despite the euro's growing global role as a reserve currency. They stress that the euro area must build an international strategy commensurate with the international status of its currency, and recall that the EMU policy agenda will be marked by the challenges posed by emerging Asian economies. Global imbalances related to exchange-rate fluctuations between, inter alia, the US dollar and the renminbi yuan and the euro must also be addressed in order to avoid future financial crises, and the committee invites the Eurogroup, the Council and the ECB to step up coordination of their action in the sphere of exchange rate policy accordingly. Members stress the importance of exchange rates in the preparation of forthcoming G-20 summits. Such preparation should be more transparent within the EU and that Parliament should be kept informed.

Report on the 2009 annual statement on the euro area and public finances

The European Parliament adopted a resolution on the 2009 Annual Statement on the Euro Area and Public Finances.

Parliament is alarmed by the ongoing contraction of employment in the EU despite the exceptional efforts of monetary and fiscal policy. It stresses that, in addition to the exceptional recovery measures, structural reforms must be stepped up rather than stalled, so as to make the European economy and labour market more robust. It welcomes the active and flexible monetary policy of the ECB since October 2008 in extending liquidity provisions to credit institutions, but is concerned that the extra liquidity has not been used by all banks to ease the 'credit crunch' faced particularly by small and medium-sized businesses (SMEs).

Parliament is also concerned about the economic consequences for the euro area of a rapid fall in the value of the US dollar and the renminbi yuan, the latter artificially devalued by an unfair intervention on the part of the Chinese Government, and the possibility of a new asset bubble in Asia. It calls for enhanced international macroeconomic dialogue in order to adjust exchange rates so that a more balanced world economy may be achieved.

The resolution underlines the fact that the discipline of wage moderation also acts as a brake on the growth of household income and

therefore warns against focusing exclusively on wage moderation as an instrument to achieve price stability. It stresses that real salaries should rise in line with productivity gains, in order to guarantee long-term stability in the distribution of income.

Parliament feels that exchange-rate fluctuations constitute an impediment to global economic recovery and that coordination of monetary policy is essential to avoid the emergence of financial imbalances. It calls for a world monetary conference to be organised under the auspices of the IMF as a forum for global consultation on monetary questions.

Improving coordination and cooperation on economic policy: Parliament shares the Commission's concerns about accumulated imbalances in the euro area. It calls on the Commission to develop diagnostic tools and indicators, in order more effectively to assess economic developments in Member States, including multilateral surveillance of unit labour costs, real exchange rates, financial markets and policies affecting competitiveness. It also suggests that the Commission examine possible ways of improving effectively the economic governance of the euro area, including the setting-up of new mechanisms to prevent the renewed excessive growth of such imbalances in the future and the asymmetric shocks to which they contribute.

Members also make the following points:

- a deepening and broadening of macroeconomic surveillance is urgently needed;
- supervision and regulation of financial markets, fiscal discipline and the limiting of internal and external deficits are essential for the successful development of the EMU;
- excessive recourse to the EIB, which would result in the budgetary procedure being circumvented and would prevent Parliament from giving its opinion on the trajectory of committed expenditure;
- the need for comprehensive application of the rules of the SGP while noting that the rules laid down in the SGP refer only to public deficit and public debt. It considers that fiscal coordination should go beyond the current scope of the SGP;
- the current economic and financial crisis and the strengthened financial coordination among Member States that have already adopted the euro should not result in an encapsulation of the euro area;
- economic coordination should take the form of an integrated European economic and employment strategy on the basis of the forthcoming EU 2020 Strategy, the Integrated Guidelines, the Sustainable Development Strategy and the convergence and stability programmes.

Public finances: noting that Member States' public deficits are set to increase rapidly to about 7% of GDP in 2010, Parliament expresses its deep concern over the unsustainable level of public debt and its predicted rapid increase in 2010 and 2011. It takes the view that, once out of the current recession, there is a need, while complying with the reformed SGP of 2005, to strengthen the preventive arm of the pact in order to ensure that Member States refrain effectively from pro-cyclical policies during periods of growth.

Parliament supports the Commission's use of the excessive deficit procedure in order to reduce public deficit and emphasise the importance of quantifiable programmes for balancing the public finances in Member States, starting in the years 2010 and 2011. It is extremely concerned at developments in the deficit situation in Greece, and calls for lessons to be learnt from this situation, in future enlargements of the euro area, especially in relation to the quality of statistical data. In this regard it considers that the legal underpinning of national statistical authorities' professional independence should be pursued in those Member States where this has not yet been done.

The resolution states that Member States with difficulties in sustaining their public finances should, in the first instance, be responsible for resolving those difficulties, particularly by means of a more appropriate fiscal policy, and it calls on Member States to accelerate the pace of their reforms through determined policy actions. Parliament also regrets that there are no binding commitments among governments to enforce coordination in the euro area.

Parliament calls on the Commission to propose a set of measures to help Member States restore balance in their public accounts and finance public investment through:

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The Commission is also called upon to:

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- make a concrete proposal as soon as possible as to how the financial sector should contribute to the cost of the crisis;
- with the ECB and euro Member States, encourage the process of economic and monetary integration within the EU and to support enlargement of the euro area.

Lastly, Parliament stresses the importance of using effectively the new provisions in Article 136 of the TFEU to improve economic coordination and governance in the euro area, and it looks forward to concrete proposals in this respect.

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Parliament stresses the importance of exchange rates in the preparation of forthcoming G-20 summits. Such preparation should be more transparent within the EU and that Parliament should be kept informed.