Procedure file

Basic information

INI - Own-initiative procedure	2010/2038(INI)	Procedure completed
Long-term sustainability of public finances for a recovering economy Subject 4 Economic, social and territorial cohesion 5.05 Economic growth 5.10.01 Convergence of economic policies, public deficit, interest rates		

Key players

European Parliament	Committee responsible	Rapporteur	Appointed
	ECON Economic and Monetary Affairs		20/10/2009
		S&D HOANG NGOC Liem	
	Committee for opinion	Rapporteur for opinion	Appointed
	BUDG Budgets		17/03/2010
		S&D KALFIN Ivailo	
	EMPL Employment and Social Affairs (Associated committee)		22/10/2009
		S&D COFFERATI Sergio Gaetano	
European Commission	Commission DG	Commissioner	
	Economic and Financial Affairs	REHN Olli	

Key events

14/10/2009	Non-legislative basic document published	COM(2009)0545	Summary
11/03/2010	Committee referral announced in Parliament		
11/03/2010	Referral to associated committees announced in Parliament		
04/05/2010	Vote in committee		Summary
07/05/2010	Committee report tabled for plenary	A7-0147/2010	
19/05/2010	Debate in Parliament		
20/05/2010	Results of vote in Parliament		
20/05/2010	Decision by Parliament	T7-0190/2010	Summary
20/05/2010	End of procedure in Parliament		

Technical information

Procedure reference	2010/2038(INI)
Procedure type	INI - Own-initiative procedure
Procedure subtype	Initiative
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Stage reached in procedure	Procedure completed
Committee dossier	ECON/7/02196

Documentation gateway

Non-legislative basic document		COM(2009)0545	14/10/2009	EC	Summary
Committee draft report		PE438.509	12/02/2010	EP	
Amendments tabled in committee		PE439.430	09/03/2010	EP	
Committee opinion	EMPL	PE438.426	22/03/2010	EP	
Committee opinion	BUDG	PE439.962	09/04/2010	EP	
Committee report tabled for plenary, single reading		A7-0147/2010	07/05/2010	EP	
Text adopted by Parliament, single reading		T7-0190/2010	20/05/2010	EP	Summary

Long-term sustainability of public finances for a recovering economy

PURPOSE: to examine the long-term sustainability of public finances for a recovering economy.

CONTENT:

This Communication and its companion Report (Sustainability Report 2009) assess the sustainability of public finances in the EU Member States. It is issued in the context of the reflection on strategies to exit from the economic and financial crisis and on the convergent and coordinated framework for the reform of Europe's economies at the core of the strategy for Europe 2020.

An acute challenge after the crisis: the communication notes that thanks to effective and substantive policy action since autumn 2008, coordinated in the context of the European Economic Recovery Programme (EERP), a financial meltdown and a generalised loss of confidence has been avoided. However, even if there are some signs of the green shoots of recovery in the European economy, uncertainty remains high: economic activity is set to shrink by 4 percent this year, while growth in 2010 will be slim.

Discretionary budgetary stimulus measures have provided a cushion to economic activity but have also resulted in a substantial deterioration in government accounts. From a deficit of 0.8 percent of GDP in 2007 ? the best result for 30 years ? the government deficits in the EU are forecast to average 6 percent of GDP in 2009 and around 7 percent in 2010. In the three years to 2010, the gross debt ratio for the EU as a whole is increasing by more than 20 points. The available projections show that, in the absence of ambitious efforts to implement structural reforms and consolidate government accounts, there would be very large increases in expenditure on debt interest and public pensions, as well as on healthcare and long-term care during the coming decades.

Assessment of sustainability by country: the long-term sustainability of the public finances is a concern for all EU Member States. However, there are large variations across the Member States in terms of the degree of long-term risk that they are exposed to and the sources of that risk. There are serious sustainability gaps for most countries as a result of the economic crisis, and several countries (Ireland, Spain, Latvia, Lithuania, Malta, the Netherlands, Austria, Poland, Slovakia and the United Kingdom) now find themselves in the long-term high-risk category. The deterioration in sustainability gaps is especially severe in those countries most seriously affected by the crisis. However, thanks to consolidation and pension reform, Hungary and Portugal have shifted from the higher to the medium-risk group of countries.

Policy challenges: the crisis-related deterioration in public finances and the projected increase in expenditure due to demographic change both constitute major policy challenges. Public finances, including social protection systems, have cushioned the economic and social impact of the crisis. Notwithstanding the need to keep supporting the economy and avoid choking an emerging recovery, measures to improve fiscal sustainability should be implemented in a decisive manner as soon as conditions allow it, to avoid a more severe correction at a later stage. The reduction in debt ratios will have to come from a combination of fiscal consolidation and structural reforms to support potential growth.

The strategy to prepare for the economic implications of the demographic changes has been in place since the 2001 European Council of Stockholm. This strategy includes (i) deficit and debt reduction, (ii) increases in employment rates and (iii) reforms of social protection systems. It has shown its validity and remains applicable. While, prior to the crisis, the three prongs of the strategy were options from which countries could choose, each of these pillars is now indispensable for most EU countries.

1) Reduce debt: simply overcoming the ongoing economic and financial crisis without fiscal consolidation in a determined manner will not

suffice to bring government debts to asustainable path. Projections based on a scenario of growth returning to the long-term path of before the crisis show that without consolidation, the gross debt-to-GDP ratio for the EU as a whole could reach 100 percent as early as 2014, and keep on increasing. Thus, although fiscal support must be maintained until recovery is secured, fiscal policies must progressively be reoriented towards sustainability. A fast reduction in the debt ratio will also depend on an orderly disposal of assets accumulated in support of the financial sector, and an effective management of contingent liabilities.

2) Increase employment rates: where employment is contracting and unemployment is rising, there is a need to avoid cyclical unemployment becoming entrenched, an increase in long-term unemployment and a reduction in participation rates. Policies should be in synergy with the social goals of supporting the income of the most disadvantaged citizens, which in itself will assist stimulating aggregate demand. Short-term policies to address the crisis should not run counter to long-term reform strategies, including the implementation of the flexicurity principles under the Lisbon Strategy. In particular, Member States should refrain from using policies such as early retirement schemes in order to mitigate the impact of higher unemployment and industrial restructuring. Reforms must also focus on improving the functioning of the EU?s knowledge triangle of education, R&D and innovation, which contribute to technological developments and productivity growth, and efforts in relation to green technologies.

3) Reform social protection systems: the main policy lever to ensure sustainability is through reform of pension and healthcare systems.

- Pensions: several reforming avenues are possible and have been implemented or are being contemplated by several countries. In several countries, future pensioners have been encouraged to top-up their public pensions with their own savings and funded old-age income. Yet, developments in financial markets during the crisis have illustrated the risks associated with the shifting of a large share of pension provision to privately-managed funded schemes, and has reduced the political and social support to implement reforms that leave a large proportion of pensions subject to market fluctuations. The Commission will continue to work with the Council and the Member States to identify lessons for the design of funded schemes and target beneficiaries in order to secure adequate and sustainable private pension provision. Each country will have to identify the reforms that better fits its own characteristics and social preferences and consensus will be desirable to implement them. Increases in the effective retirement age that reflect gains in longevity are being contemplated in several Member States and merit wider consideration.
- Healthcare: the projected long-term increase in healthcare spending is large and constitutes on its own a risk to sustainability. Given its multidimensional nature, a reform of healthcare needs to consider several complex issues, on ways to make health system more efficient; on the resources allocated to preventive and curative medicine; on responding to the challenge of maintaining an appropriate healthcare workforce; on the balance of financing between patients, public and private insurers; the degree of competition among providers of care; on the effective assessment and management of technology aiming at fostering efficiency and ensuring high-quality services while rationalising costs; or ethical issues like access to expensive treatments.
- Quality of public finances: as public resources are scarce, an increase in the quality of public finances is indispensable. Modernising public services and reducing non-productive expenditure helps stemming the debt increases, frees resources to invest in growth-boosting areas such as education, research and innovation, and other policy objectives (social, environmental, health) and strengthens incentives for raising the productive capacity of the economy. Fiscal consolidation through raising additional revenue should take account of incentive effects, efficiency and competitiveness, be focused on those measures with the least distortionary effects, in particular on labour participation and capital accumulation, while contributing to meeting other goals (e.g. green taxes).

In conclusion, the Commission considers that rising government expenditure and prospects of an ever-increasing debt would be an obstacle to a sustained and long-lasting recovery and balanced economic growth.

Fiscal exit strategies aiming at achieving ambitious and realistic medium-term objectives need to be designed now, and implemented in a coordinated manner as soon as recovery takes hold, taking into account the specific situations of individual countries. To support the required reforms and enhance the credibility of fiscal adjustment ? which inevitably stretches over a number of years ? Member States may also need to develop further their own stability-enhancing institutional arrangements. In the Stability and Growth Pact context, debt sustainability should get a very prominent and explicit role in surveillance procedures.

Long-term sustainability of public finances for a recovering economy

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.

Long-term sustainability of public finances for a recovering economy

The European Parliament adopted by 302 votes to 275 with 32 abstentions, a resolution on the long-term sustainability of public finances for a recovering economy in response to the Commission communication on the subject.

The rapporteur, Liem HOANG NGOC (S&D, FR), asked that his name be removed from the resolution.

Parliament 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. Parliament 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, and a shift from the 'spend first, repay later' attitude to a 'save for a possible future emergency' principle. A deficit of 3% is not an aim, but the absolute limit allowed for, even under the revised Pact.

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.

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