

## CEEP POSITION PAPER ON AGS 2012<sup>1</sup>

Presented at the Macro-Economic Dialogue Meeting  
of January 31<sup>st</sup>

### (1) SUMMARY

CEEP considers that the analysis of the situation is valid, and that policy priorities and recommendations are mostly well chosen, but incomplete. In particular, the widening “growth gap” remains unaddressed and risks rendering the recommended strategy socially and politically unsustainable.

### (2) ON THE ANALYSIS

It is rightly stated

- that the negative feedback between the sovereign debt crisis and fragilities in the financial sector is adversely affecting confidence and thus investment and consumption;
- That stagnation and unemployment will exacerbate the social impact of the crisis;
- That a “convincing response” to the Euro area crisis is needed in the interest of the whole Union;
- That too much political focus has been placed on emergency measures and too little on policy changes conducive to bringing back higher growth;
- That the right growth model must be chosen and that financial markets are assessing the sustainability of sovereign debt on the basis of long-term growth prospects.

However, the role attributed to Social Partners is limited to supporting implementation of the strategy, ignoring their consultative role in policy design.<sup>2</sup>

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<sup>1</sup> Annual Growth Survey 2012, Communication from the Commission of Nov. 23<sup>rd</sup>, 2011, COM(2011) 815 final, plus annexes.

<sup>2</sup> “The social partners will have an important role to play in implementing some of these recommendations” (p. 2 of main document).

### **(3) ON POLICY PRIORITIES AND RECOMMENDATIONS**

The first four of the five priorities reflect essentially basic Treaty objectives and cover the same substance as last year. The notable exception are macro-economic imbalances, whose correction had been considered an important policy objective, but which are no longer mentioned. At the same time, modernising public administrations is introduced as a new priority.

On the detailed suggestions and recommendations, CEEP's position is as follows:

- Yes to differentiated fiscal consolidation, which is now inevitable for objective and for self-induced reasons: The objective reason is that the financial crisis and the recession have made the dynamics of deficits and debts unsustainable. The policy contribution has been that Euro zone Members were/have been exposed to overreacting financial markets.

It appears that the now agreed fiscal strategy implies an annual consolidation effort of about 1 percentage point of EU-GDP over a number of years. This unprecedented degree of fiscal restriction coincides with a slowing world economy, low confidence by economic actors and effective interest rates well above the expected growth of nominal GDP.

No to the “one-size-fits-all” recommendation of keeping public expenditure growth below medium-term trend GDP growth. As observed already last year, the size of public budgets differs widely across the Union (between 37 % to 59 % of GDP!)<sup>3</sup> while deepening integration, in particular a “Fiscal Union”, calls for convergence rather than for parallel shrinking. Equally importantly, these choices are an eminently political decision to be taken at national level which should not be overruled by mechanic formulae.

Yes to prioritising growth-friendly expenditure and labour market policies, and ensuring efficiency of such spending.

Apart from being an investment in human capital, education services have also been a dynamic source of job creation (more than a million in the EU-27 in the three years to 2010).

Yes also to aligning pension and health care systems to what can be afforded, and to making them cost-efficient.

However, a healthy population is both a value in itself and an investment in human capital while the growing demand for health services is again an important source of job creation (about half a million in the EU-27 in the three years to 2010). Health care

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<sup>3</sup> Applying to Romania and Denmark, respectively, ignoring the special case of Ireland (ratio of 67 %, implying an increase over the previous year of 18 % points. Within the Euro area, expenditure-to-GDP ratios range from 40% (Slovakia) to 57 % (France). The area averages are 51 % for both the Euro zone and the EU-27. All 2010 data. Source: Eurostat Press Release of Oct. 21<sup>st</sup>, 2011.

spending has thus also an important economic dimension and should not be seen from a purely budgetary perspective.

And a big caveat to “supporting the development of complementary private savings to enhance retirement incomes”. It should be remembered that the related promotion schemes have been expensive to the taxpayer while a big portion of the entitlements has evaporated in the financial crisis. Until the financial sector has been tamed, promoting private pension schemes thus risks to be a highly inefficient instrument.

Certainly yes to making tax systems more effective, efficient and fairer. Yes also to broadening the tax base, including phasing out environmentally harmful subsidies; as well as to shifting taxes away from labour towards taxation which is less detrimental to growth. An updated OECD study on the subject will provide new inputs.<sup>4</sup>

But again no to ignoring the fact that tax levels and tax structures across the EU should converge over time. This issue will need careful attention when formulating country-specific recommendations.

Therefore also yes to enhanced dialogue at EU level to coordinate tax measures, also with a view to agreeing on a common consolidated corporate tax base, on a financial transaction tax and on energy taxation, as already proposed by the Commission.

- Again certainly yes to making normal lending to the economy a priority. Yes also to the importance of a healthy financial system and a robust banking sector for supporting growth, and of avoiding bank excesses in risk taking. Two complementary suggestions, however:

First, in the context of strengthening banks’ capital position, the issue of a prudent dividend policy should also be mentioned (re-investing surpluses). Second, explicit (and not just implicit) reference should be made to the importance of reigning in shadow banking, a primary contributor to the financial crisis which has up to now largely remained unregulated and even unrecorded.

- Yes by definition to the priority of “promoting growth and competitiveness for today and tomorrow”, and yes to the insight that fiscal consolidation and financial repair are needed, but are not sufficient in themselves to deliver growth.

Yes also to most individual measures. Mobilising the EU budget to a greater extent for building European infrastructure is particularly welcome.

However, all the recommended measures aim at raising the growth potential while the current problem is insufficient growth. There is a great difference between the two, both in practical terms and in terms of policy implications.

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<sup>4</sup> See Hagemann, R.: Fiscal Consolidation: Part 6. What are the Best Policy Instruments for Fiscal Consolidation?, OECD Economics Department, Working Papers No. 937 of Jan. 10th, 2012.

The implicit suggestion seems to be that a higher growth potential will automatically translate into higher growth, and that cyclical considerations can be ignored. This is not so. In the current environment of uncertainty, the causation line will rather run in reverse direction, as evidenced by recent events: As a result of the recession, potential output has been assumed to have receded, in terms of both level and trajectory.

The conclusion is that in the current environment, cyclical conditions will matter more for growth and employment than specific structural improvements.

This means in turn that even the highest labour productivity, the fastest broadband connections and the fiercest competition in the retail sector, all helped by fast track legislative procedure, will do very little for closing today's and tomorrow's growth gap.

The recommendations also raise a conceptual question: Last year it was suggested that raising competitiveness through structural measures should also be a key lever in redressing intra-Eurozone current account imbalances. While this suggestion was not convincing, it is puzzling to note that macro-imbalances have now disappeared altogether, even though a stringent surveillance procedure has just been instituted.

- A definite yes to the 4<sup>th</sup> priority of “tackling unemployment and the social consequences of the crisis”, and to the presented objectives and recommendations.

Yes also to the annexed Joint Employment Report. It has the right thrust and suggests a comprehensive set of useful and urgent measures.

However, again the overall conclusion is that there is a growing gap between the scale of the problem and what micro-economic measures are able to deliver.

This gap could be narrowed through a well-designed wage strategy. The recommendation to revise wage-setting mechanisms in order to better reflect productivity developments is a progress over previous drafts, but needs to be made operational.

The Commission should deepen its analysis and present an empirically sound study on the macro-economic impact of various wage-setting practices and outcomes. On this basis, it may be easier for Social Partners to develop a common understanding of the pros and cons of various approaches, overcome the current impasse and take their rightful place in EU policy design.

- Finally, yes also to the fifth suggestion of “modernising public administrations”. While it appears somewhat arbitrary to put it at par with the other objectives which essentially echo Treaty goals, it is a timely issue. Work should build on the substantive analyses already performed elsewhere (e.g. OECD). The recommended actions will be useful in themselves, but their selection appears again somewhat arbitrary.<sup>5</sup>

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<sup>5</sup> It is recommended to minimise the administrative burden, promote on-line services, reduce time for company start-ups to three days and to absorb EU Structural Funds faster.

In this context, CEEP also wishes to point out the definitional differences between “public services”, “public sector” and “public administration”, terms which the Commission seems to use synonymously in this and other document (e.g. EU-2020).<sup>6</sup>

#### **(4) CONCLUSIONS**

The overall assessment is that most measures will be useful, but that their overall effect will be restrictive. This is so because fiscal consolidation will take its toll on activity and employment while the potential contribution of micro-economic measures is necessarily limited, particularly in the short run.

The priority of priorities is to restore confidence of economic actors, including financial markets, but equally important, also consumers and investors. This alone will do. More thought needs to be given how this can be achieved.

Simply saying that “most of the growth levers are in the hands of the Member States”<sup>7</sup> is not only analytically wrong, but also economically and politically dangerous.

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<sup>6</sup> The concept of “public services” is synonymous with that of “services of general interest” (functional definition) while the terms “public sector” and “public administration” refer to the institutional aspect.

<sup>7</sup> P.7 of the main document.