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on European economic governance and EU tools for economic and social recovery

Special Committee on the Financial, Economic and Social Crisis

Contribution by Magdalena Alvarez
Thematic Co-Leader to the Rapporteur

Rapporteur: Pervenche Berès

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United in diversity

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European economic governance and EU tools for economic and social recovery

Context

The economic situation remains complex and uncertain. What started as a financial crisis, and subsequently developed into an even deeper economic and social crisis, has now become a sovereign debt crisis. This poses a whole new set of challenges for the European authorities.

Despite analysts' concerns having focused in recent months on the sustainability of public finances, we should not forget that the crisis was not caused by fiscal slippages in national economies. This is clearly proven by the fact that those countries with a surplus and a relatively low level of debt have been seriously affected by the crisis.

The origin of the crisis was indisputably financial. Monetary policy, understood in a broad sense, has been unable to ensure the smooth running of the financial system and sustain economic activity. That is why a tough anti-cyclical fiscal policy was needed, which has funded intensive rescue plans, stabilised economic activity, overcome the short-term effects of the crisis and temporarily compensated for the limitations in European monetary policy.

However, because of the level of debt in public sectors, this fiscal policy should not be continued long term, and it cannot compensate for the lack of credit that will remain an issue in the medium term. The medium- and long-term sustainability of the economic recovery will depend on future macroeconomic policies being appropriately structured.

The crisis has prompted an examination of both the European structure and European governance. It has revealed the main shortcomings in the European decision-making mechanisms and systems of governance in the euro area.

In this context, Europe is faced with the dilemma of more Europe or less Europe. Despite the differing situations in the various European economies, the most important issues must be decided together, as the inherent advantages of a comprehensive European response form the key to emerging strengthened from the crisis.

As a result, we need more and better Europe.

With the entry into force of the Lisbon Treaty in December 2009, the EU now has a more appropriate **framework** for adopting the necessary reforms. In this respect, decisions need to be taken promptly and effectively so that we can move towards better governance.

The fundamental **aim** must be to achieve levels of growth that allow stable and high-quality jobs to be created.

The **strategy** of effectively combining economic policy measures, to ensure that changes are made in substance as well as in form, and the benefits of this strategy must be felt as soon as possible throughout the EU.

It is this aim and this strategy that guide the following financial and fiscal proposals:

1. Better governance of the European financial system

The current crisis has shown how in recent decades the financial system has been moving away from its main function – namely, serving the real economy – and how purely speculative transactions, which are clearly harmful to the stability of the system, have increased exponentially. As a result, the priority must be for the financial system to work for the benefit of productive and high-quality investment, thereby ensuring stable economic growth.

The measures proposed are as follows:

A. At national level

Coordination of Member States' decisions on their respective financial systems: mechanisms must be defined and created to ensure that measures to strengthen and recapitalise national financial systems comply with common guidelines laid down by the EU, so that there is a joint response to the challenges facing the global financial market. This would also prevent distortions in capital flows within the EU and possible unfair competition between Member States.

B. At EU level

We must improve the transparency, credibility and stability of the financial system. To this end, the following proposals could be studied:

Acceleration and expansion of the reforms initiated in the European financial system

The various institutions responsible at EU level must positively encourage a move towards better regulated and supervised financial markets. The crisis has shown that the financial system and the real economy are closely linked, which is why we must not only improve control of the various markets, but also carefully assess the links between them.

With this aim in mind, the reforms included in the de Larosière report, and debated in this Parliament, must be quickly adopted and sufficiently funded to ensure that their effect is wide-ranging.

In addition, the recommendations made by the new supervisory authorities and the future European Systemic Risk Board should be binding, both on those entities that may run cross-border risks and on those transactions that may be regarded as not transparent. The possibility of banning such transactions could even be considered.

Stability Fund

To increase financial stability and prevent speculative attacks on Member States, it is proposed to set up a Europe-wide financial stability fund, which will operate in a similar manner to the IMF. Countries would be able to access this fund after submitting a reform and macroeconomic adjustment plan accepted by the fund's managing authority. Assistance would be conditional on this plan being duly implemented, which would therefore limit the possible moral hazard that may arise.

Its funding would be managed by the Eurogroup, through the issue of European bonds, which would pave the way for a sovereign debt market to be created in the euro area. The euro-denominated bonds would also serve to attract foreign capital and would increase the liquidity, depth and solvency of the European debt market. The fund would also help to consolidate the euro as a global reserve currency, by discouraging possible speculative movements.

A European deposit guarantee fund

Setting up a Europe-wide deposit guarantee fund would allow struggling cross-border banks to be supported and would therefore reduce the EU's systemic risk. This fund should be established through contributions from those entities with cross-border activities in the sector. In setting up this fund, we should use the best practices that have been proven in existing funds, both within the Member States and internationally.

European rating agency

It is also proposed to set up a European rating agency in order to improve the credibility of information on the credit quality of security issuers and their financial liabilities. Experience has shown us that outsourcing these functions has not always offered the best results, but instead has led to unjustified instability in the economy. The possibility of setting up an ECB department with this responsibility, which would use the information available to the ECB, could be studied.

List of financial instruments according to their associated risk

The creation and publication of a list of financial instruments on the market, ranked by their risk level, and the establishment of conditions for their acquisition would undoubtedly help to increase transparency and reduce distorting effects in the financial market.

The ranking could be as follows: firstly, the safest instruments, which would be available to the general public; secondly, those instruments for which a licence would be required in order to acquire them; thirdly, those instruments that could only be acquired by highly qualified institutions; and finally, above a given risk level, the acquisition of certain products could be restricted.

Creation of clearing houses in unregulated or unofficial markets

The aim of this proposal is for these clearing houses to function as intermediaries, thereby guaranteeing the bilateral transactions carried out. This would also help to increase the transparency of these unregulated markets, as all transactions would have to be registered and could therefore be checked by supervisors.

Anti-cyclical ratios

In order to make the prices of financial assets less volatile and prevent the formation of speculative bubbles on the markets, we should look at the benefits of introducing anti-cyclical ratios to improve the ranking of liquidity in the system, ensure that entities have the appropriate level of leverage, and more precisely determine the acceptance of risk in the market, with a greater or lesser requirement for collateral. In this way, by using specific ratios, we would ensure a much more appropriate and more effective outcome, compared to the monetary policy mechanisms employed to date.

2. Coordinated, sustainable and anti-cyclical European fiscal policy

Fiscal policy has become the key tool for reinvigorating economic activity and compensating for the apathy of private investment. As a result of this apathy, the public finances of European governments have taken a severe hit.

On the understanding that sustainable public finances are vital, in a context of weak economic growth and high unemployment, the immediate consolidation of public finances could be counterproductive. Stimulus measures must be maintained until the economic recovery is well-established, thus avoiding the risk of reversing the signs of incipient growth.

We must increase the coordination of European fiscal policy, which must have a solid anti-cyclical function and which must be sustainable in the medium and long term.

As a result, we need to combine measures to increase income with appropriate control of spending.

A. Income measures

From the **perspective of the Member States**

The emphasis must be placed on **combating tax fraud**. This strategy must be a priority, as tax fraud represents a real drain on national budgets, seriously distorts competition and threatens the principle of fairness in the application of tax.

Reducing the effects of this tax fraud would significantly increase income, which in turn would relieve the growing pressure on public finances and *would lead* to a fairer tax system, which is too heavily dependent on wage earners.

The Council, together with Parliament, must therefore **speed up the adoption of the directives on savings and administrative cooperation in the field of taxation**. The European Union could also promote a **pilot plan against tax fraud**, enshrining the principles of transparency, automatic exchange of information and institutional loyalty.

From the **EU perspective**

It is vital that we ensure the EU's **financial independence** by introducing a series of **pan-European taxes**, which will increase the EU's ability to develop its own initiatives and/or correct certain conduct.

Firstly, there could be a **tax on financial transactions**, with the triple objective of fundraising, information-gathering and reduction of speculative transactions. If this tax is properly designed, it will firstly form an important and permanent source of income from the financial sector to the real economy and, at the same time, will provide information on financial instruments and capital movements. It will also reduce speculative transactions by making them more expensive, with the effect that unproductive activities will be limited.

The worldwide imposition of this tax would be the best scenario, which is why it must be negotiated between the G-20 leaders. In this way, its effectiveness will be maximised and competition distortions will be avoided.

The EU should in any case aim to impose this tax at European level, by analysing its effects and the various alternatives.

Secondly, there could be a **special tax on those transactions originating in or destined for jurisdictions that do not cooperate in tax matters**. In this case, the aim is to deter the opacity and impunity with which transactions are carried out in ‘tax havens’, and therefore reduce tax evasion.

Thirdly, there could be a **tax on the bonuses** received by executives. The pay of executives must be based on the medium- and long-term results of companies, and not on the short-term earnings, as has been the case to date. In this respect, a tax on bonuses would discourage too much focus being placed on short-term objectives and therefore excessive risks being taken in the economy.

This would effectively involve applying the ‘polluter pays’ principle in the financial markets.

Lastly, there could be **‘green taxation’**, in particular the **tax on carbon use**. This would help to promote the use of clean energies and therefore the development of a whole sector with a huge capacity for job creation and wealth throughout Europe.

B. Spending measures

In a context in which spending must be constrained, both the Member States and the European Union must selectively reduce their spending and redirect it towards productive investment, in those areas with a structural impact such as education, infrastructure or RD&I. This will have a dual effect: in the short term, it will reinvigorate economic activity and, in the long term, it will allow for the reforms needed to achieve a new model of intelligent, sustainable and integrated growth, in line with the EU 2020 Strategy.

At national level

The Member States must make **profound changes to their spending policies**, in order to bring them into line with the aims of a new model of European growth. They must therefore: promote active employment policies; give strong support to SMEs; help to restructure the industrial sector within the framework of the EU Single Market; clearly commit to investment in the ‘knowledge triangle’ (education, research and innovation); and prioritise green technologies.

These national policies must be coordinated within the Stability and Growth Pact (SGP), which is the only tool for budgetary harmonisation and the main tool for economic governance in EMU. We must highlight the SGP’s function as an instrument of growth and apply it in a manner more consistent with its anti-cyclical role.

More and better information is vital, which is why **the planned reforms of Eurostat** in relation to the control of public finances must be speeded up, to ensure greater transparency and trust and provide new **structural ratios** allowing us to properly understand the sustainability of long-term public finances, regardless of the effects of the present situation.

We must also avoid equalising current spending and investment. The application of the **golden rule** will allow us to correctly determine strategic investments within the annual deficit, in line with EU objectives and the plans approved by EU leaders.

At EU level

It is proposed to **reinforce the investment role of the EIB** so that it becomes the driving force for future EU investment.

The economic crisis has highlighted the importance of the EIB as an investment instrument to help struggling companies and sectors and to undertake major European structural reforms.

It is the only practical, quick and effective EU-wide tool for promoting investment in those strategic sectors that can stabilise the economic recovery.

Its mandate must therefore be reinforced on a long-term basis so that it can become one of the future pillars of the new European governance.

3. Towards a new model of growth

The economic crisis has shown us that we need proper economic government of the European Union in order to steer the recovery and lead the EU towards a new model of growth.

As set out in this document, the measures to be implemented within the framework of this new governance must firstly focus on restructuring the financial sector, to make it more stable and transparent and to ensure that it once again serves the real economy. Secondly, there must be a more effective, coordinated and sustainable fiscal policy, which will help to bring about the structural changes needed. The aim behind all of this is to achieve stable growth that will create high-quality jobs.

In addition to ensuring a prompt economic recovery, these measures will also establish the foundations of a new model of medium- and long-term growth, in line with the latest proposals for the EU 2020 Strategy.

Better coordination of economic decisions will generate the political determination needed to carry through the reforms, and an increase in investment in strategic sectors will ensure that these reforms are adequately funded.

In this way, we can achieve the aims of intelligent growth, based on innovation and knowledge, sustainable growth, which is respectful of the environment as well as being competitive, and integrated growth, which is focused on a high level of employment and which promotes social and territorial cohesion.