Budgetary policy - tool for economic recovery and strategic choices

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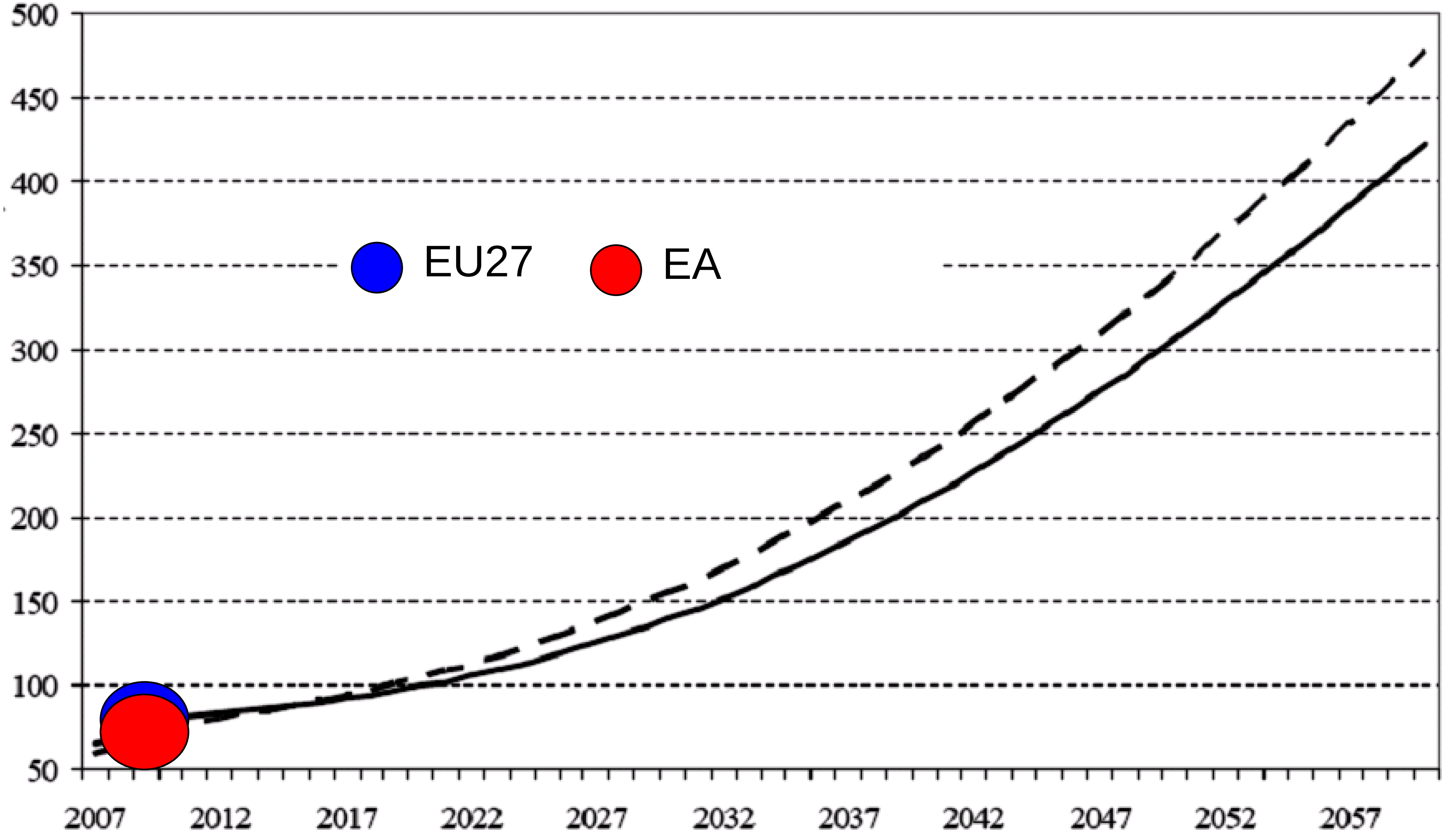
- European public finance shows an explosive path

- Higher deficits and debts are threats to higher growth rates

The dreadful path of public debt in EU

(Without intervention, in % GDP)



Source: CSC on European Commission projection.

Government deficits and debts negatively affect growth

IMF estimates show that:
a 10% increase in public debt ratio leads to a slowdown in annual growth by 0.2% of GDP, also because of higher interest rates.

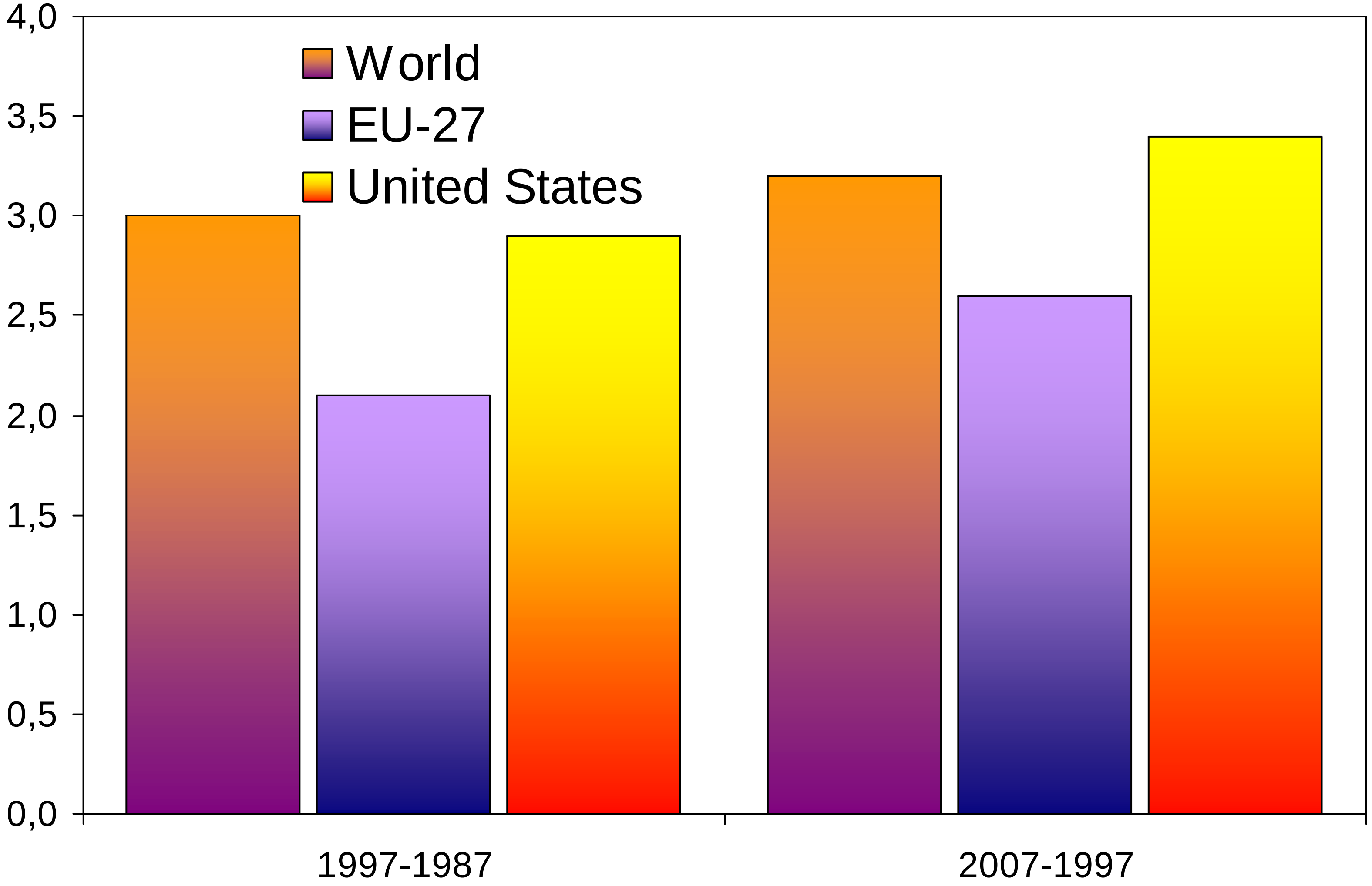
Pattillo, Poirson, and Ricci (2002, 2004)
find a negative and significant effect on growth of debt at high debt levels (both through lower investment efficiency and lower capital accumulation).

For the 15 years prior to the onset of the current crisis, **there was a negative correlation between debt ratios and growth for most advanced economies.**

- European Union can exit only arising growth rates

EU domestic demand is weak…

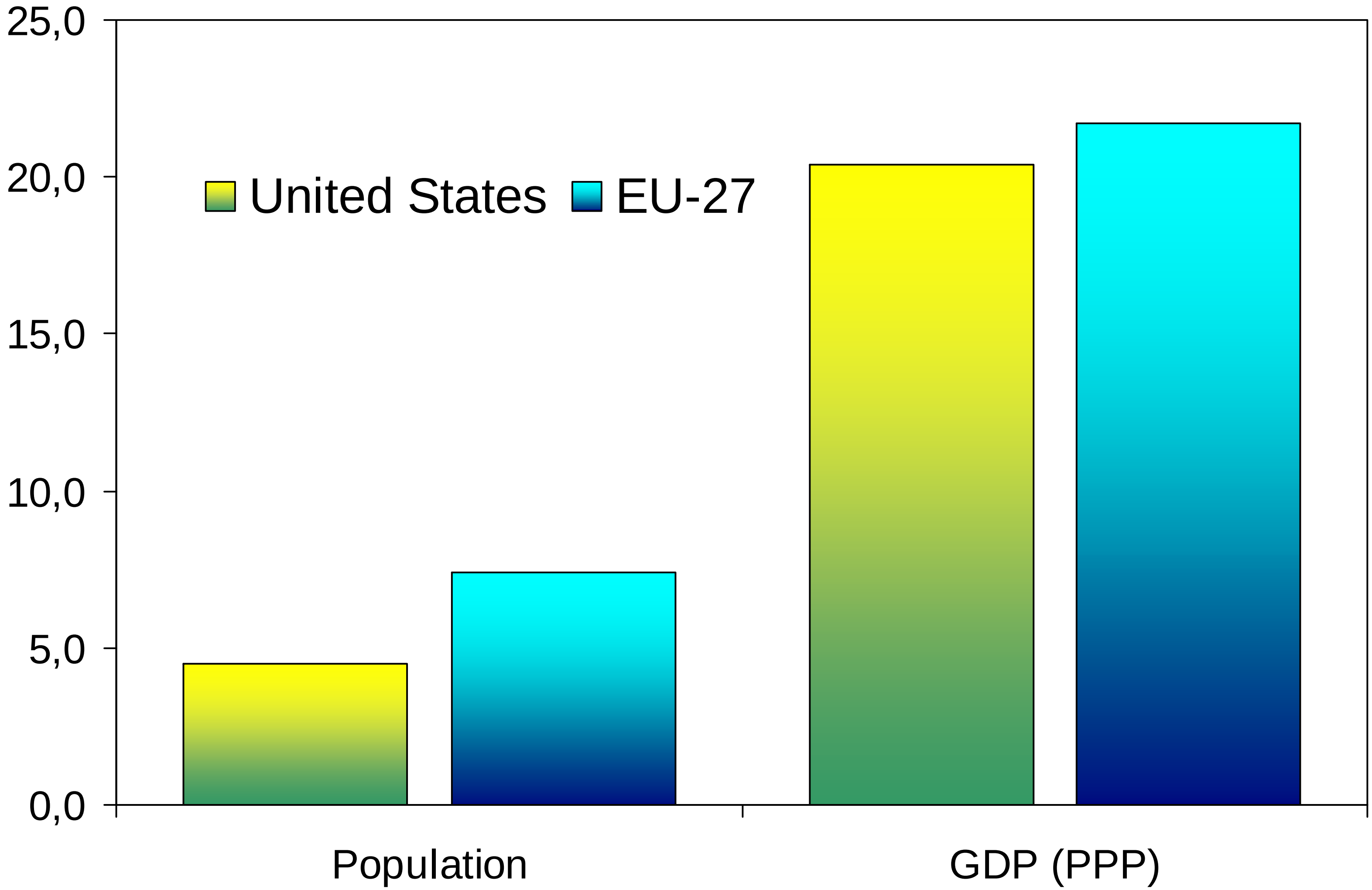
(TDD, % average growth rate)



Source: CSC on Global Insight data.

…even if EU is the biggest market

(2008, % of World)

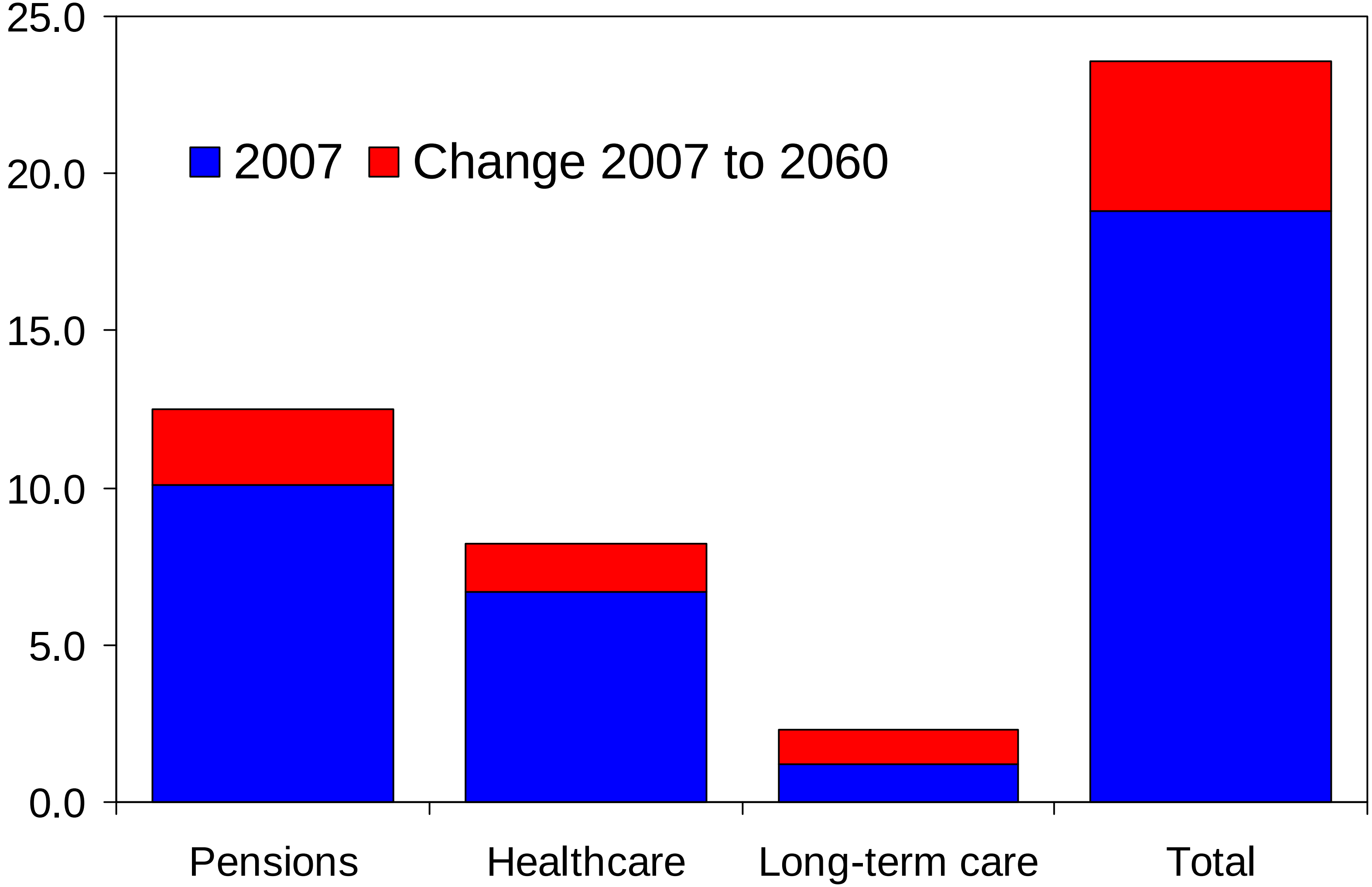


Source: CSC on Global Insight data.

- For future growth it matters the composition of public expenditure and the level of taxation

The ageing of European population will require higher public resources

(2007 and 2060 ageing, public expenditure in % GDP)



Source: CSC on European Commission data and projections.

How EU countries will adjust Government budget?

- **Increasing taxation?**
  Raising tax revenues is likely to have adverse consequences on supply-side potential

  (Bassanini et al., 2001; Ardagna,2004 and 2007; Cournède and Gonand, 2006)

- **Cutting expenditure?**
  Part of the expenditure could have a strong effect on enhancing growth

  (R&D, infrastructure, education)

Exit strategies must support fiscal sustainability…

1. **Tightening fiscal rules at EU and national level**
2. **Increasing efficiency of public administrations**
3. **Introducing credible cost cutting measures** (spending review)
4. **Increasing public-private partnership**
5. **Reforming pension systems**
6. **Improving the efficiency of health care sector**

…and regain scope for an entry strategy to enhance future growth

1. **Higher return on education and training**

2. **More resources and better efforts in R&D and Innovation**

3. **Prioritization of infrastructure investments**

4. **Growth-enhancing tax reforms**