ETUC position on the flexibilities within the Stability and Growth Pact

Adopted at the ETUC Executive Committee on 8-9 June 2016

On 13 January 2015, the European Commission released a Communication on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact". The Communication was endorsed by the Council in February 2016.

The ETUC welcomes the fact that the European Commission has taken into account the criticism of the pro-cyclical character of the Stability and Growth Pact (SGP), especially in times of crisis or "modest" recovery.

Indeed, the strict application of the SGP and the implementation of structural labour and product markets reforms show a recessionary bias and continue to be detrimental for the European economy and its social model.

There is a greater need for more flexibility to allow for much greater investment, both public and private, and to allow a longer time adjustment for Member States.

However, the ETUC believes that the flexibilities suggested by the European Commission, while softening austerity, are still insufficient with regard to the state of affairs in some European Member States and reiterates its call for a revision of the SGP. The principle of the sanctity of debt has to be rebalanced with social needs and a rights-based approach.

The lack of investment

The estimates concerning the lack of public and private investment in Europe in 2013 were between 230 billion and 370 billion Euros. Public investment both in the Euro area and the European Union has been continuously decreasing since 2009. This leaves large room for manoeuvre for additional investment.

In this respect the Juncker plan, while being an initial departure from the logic of austerity, is too weak, particularly given the size of the European economy and the severe budgetary constraints on many Member States.

In order to allow for an increase in investment, the Communication of the European Commission allows Member States to finance the European Fund for Strategic Investments, already supported by the European budget and the European Investment Bank to the value of 21 billion Euros, without triggering an excessive deficit procedure in consequence[1].

These contributions should allow an increase in the total amount invested, but do not ensure that more funds will be invested in countries with the greatest needs and experiencing difficult economic situations.

Only Member States under the preventive arm of the Pact can be eligible for "a temporary deviation" on "projects that are to a large extent financed by co-funding by the EU under the European structural and Investment Funds, Trans-European Networks and the Connecting Europe Facility, as well as national co-financing of projects also co-financed by the European Funds for Strategic Investments".

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[1] *Contributions to the EFSI "will not be counted when defining the fiscal adjustment under either the preventive or corrective arm of the Pact, because such contributions can be considered as "one-off measures" that are deducted for the assessment of the fiscal effort in structural terms".*

Furthermore, the flexibilities are subject to a set of conditions: GDP growth must be negative or GDP must remain well below its potential; the deviation cannot lead to an excess over the 3% deficit reference value while an appropriate safety margin must be preserved; investment levels must effectively be increased as a result; the deviation has to be compensated for within the time frame of the Member State's Stability or Convergence Programme.

Member States under the corrective arm of the Pact, experiencing excessive deficit procedures[2], cannot benefit from these flexibilities, although minimal, allowing temporary departures from budgetary trajectories defined in the Code of Conduct endorsed by the ECOFIN in September 2012 and complemented by the effective action methodology endorsed by the ECOFIN in June 2014.

The ETUC is therefore very sceptical about the positive impacts of such measures on investment and growth, especially for the most indebted Member States.

The ETUC requests the flexibilities to be enlarged to allow Member States in difficult situations to raise their deficit above the 3% limit for increasing public investment, to fund infrastructure and research, as well as universal and high-quality education, healthcare and social services. If, additionally, the investments launched are intended to have primarily long-term and positive budgetary effects, their compensation within a four-year horizon of their respective current Stability or Convergence Programme should be extended.

The ETUC also demands that the flexibilities provided to Member States under the preventive arm of the Pact should also be accessible to Member States under the corrective arm of the Pact.

A sound budgetary position

The European Commission has as its main objectives a "sound budgetary policy" and the "sustainability of public finances", that "allow automatic stabilisers to play their full role in mitigating possible economic shocks".

However, simple economic theory suggests that public deficits are a result rather than a cause of economic downturns. In this respect, demanding deficit reduction in times of crisis is counter-productive, as it curtails investment and growth. On the contrary, deficits may increase so as to support investment in periods of economic downturn. While sound budgetary positions over the cycle is the right objective, this could imply Member States increasing deficits and public debts for some time in order to trigger a recovery, through increased investment and public spending.

On the other hand, when a country is experiencing a boom, part of the adjustment should be made to compensate for the previous increase, while preserving the required level of investment, employment and consumption.

In this respect, the SGP is asymmetric, even with the added flexibilities, preventing counter-cyclical policies being implemented.

Further steps

The ETUC is calling for a longer-term view concerning public finances, preventing Member States engaging in austerity policies in times of crisis. The generalised failure

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[2] Currently, nine Member States are under such a procedure but the Commission wants to reduce the number to six (Croatia, France, Greece, Portugal, Spain and the UK). The EU Treaty (Art. 126) defines an excessive budget deficit as one greater than 3 % of GDP. Public debt is considered excessive under the Treaty if it exceeds 60 % of GDP without diminishing at an adequate rate.

to reduce public debt levels in Europe should not come as a surprise since this is the result of the reduction in government spending.

The ETUC regrets that public investment has become one of the first targets for adjustment. We are demanding far greater public investment in infrastructure and research, as well as in universal and high-quality education, healthcare and social services. Specific public investment in these areas should not be counted when national deficit levels are assessed. This is particularly relevant in economic downturns[3].

At least, a fixed minimum limit for public investment is needed to maintain the balance between public debt and public capital. This would ensure a minimum sustainable and stable investment level[4].The ETUC rejects the idea of simply redistributing given public resources towards investment. That would mean increasing investment at the expense of other important areas of public spending.

Given that investment is a cost to finance but also a source of future revenue, to compensate for deviation within a four-year horizon can be detrimental to growth. In addition, gross debt may be inappropriate for some Member States with substantial assets. The ETUC is therefore calling for a new indicator to complement the gross public debt position: the net public debt position, which refers to gross public debt minus financial and other assets owned by public entities. This indicator would allow policymakers to concentrate both on the financing and the revenue aspects of investments. Net government debt would allow them to evaluate the country's capacity to continue servicing its debt. Such a long-term view would limit the incentive to cut public expenditures in the short run.

The ETUC will engage in further discussions on the possibility of establishing a Euro Treasury for public investment. This would be complementary to the suggested policy changes and independent of public debt mutualisation discussions.

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[3] *See ETUC Action Programme 2015-2019, point 19.*

[4] *Such a limit could be linked to "A new path for Europe: ETUC plan for investment, sustainable growth and quality jobs", adopted on 7 November 2013. See also ETUC Action Programme 2015-2019, point 17.*