FIRST ANNUAL GROWTH SURVEY

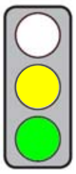
Status: 7 March 2011

cep Centrum für Europäische Politik

MAIN ISSUES

Objective of the Communication: The measures for economic policy coordination aim to encourage economic recovery in the short-term and pursue the objectives of the economic growth strategy of Europe 2020.

Parties affected: The entire population, national governments and parliaments.



Pros: (1) The Commission recommends to Member States a reduction in structural budget deficits that goes beyond that which is statutorily required.

(2) The Commission recommends that states with a current account surplus improve their investment conditions.

Cons: (1) The Annual Growth Survey fails to take into account the fact that public spending cuts are generally more conducive to growth than increasing state revenues.

(2) In particular the recommendation to increase indirect taxes is too general.

CONTENT

Title

Communication COM(2011) 11 of 12 January 2011: **Annual Growth Survey: advancing the EU's comprehensive response to the crisis**

Brief Summary

► **Background and objective**
- The Annual Growth Surveys for 2011 and 2012 mark the start of the first "European semester" (for more information about the procedure see annex).
  - The "European semester" refers to a six-month procedure for ex-ante policy coordination between the 27 Member States. This procedure provides policy guidelines and recommendations to Member States as to how to plan their budget policy in the run-up to national budget procedures [for further details see Communication on Economic Policy Coordination COM(2010) 367; see CEP Policy Brief].
  - The "European semester" is anchored in the EU economic growth strategy of "Europe 2020" [COM(2010) 2020; see CEP Policy Brief] and the planned reform of the Stability and Growth Pact (see CEP Analysis).
- The Annual Growth Survey applies to the entire EU, but it is especially relevant for the eurozone, which has been particularly hard hit by the debt crisis.
- The Annual Growth Survey contains "ten priority actions" ("key measures") for "strengthening economic recovery in the short-term", boosting labour productivity and putting the EU on track towards implementing the targets of the Europe 2020 strategy. The measures are to be tailored to the local conditions in Member States.
- The ten "key measures" described by the Commission focus on the following three areas:
  - macro-economic stability, in particular budget consolidation;
  - labour market reform and
  - growth stimulation.

► **Macro-economic stability, in particular budget consolidation**

"The most urgent task of the EU" is to restore confidence in financial markets by reducing public debt and expenditure (p. 4). The Commission believes that cutting structural (i.e. cleared of cyclical and unique effects) budget balances by 0.5% of GDP is insufficient to reduce debts.

- **Budget consolidation (Action 1)**

  In particular those Member States in excessive deficit procedure should introduce reinforced fiscal rules in order to consolidate public finances and to restore confidence in financial markets, as well as to establish the prerequisites for future growth (p. 5). Member States need to:
  - keep public expenditure growth "firmly below the rate of medium term trend GDP growth", while prioritising that which the Commission deems "sustainable growth friendly expenditure in areas such as research and innovation, education and energy",
  - speed up budget consolidation where economic growth or revenues turn out to be higher than expected;

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- consider increasing taxes whereby:
  - increasing indirect taxes is more "growth friendly" than increasing direct taxes;
  - broadening tax bases is "preferable" to increasing tax rates;
- "unjustified subsidies" – e.g. environmentally harmful subsidies – should be eliminated (p. 4).

– **Correcting macro-economic imbalances (Action 2)**

Member States are to correct their macro-economic imbalances and to improve their competitiveness.

- Member States with high levels of indebtedness and large current account deficits should present "concrete corrective measures", e.g. the revision of indexing clauses in bargaining systems (p. 5).
- Member States with large current account surpluses should "identify and tackle the sources of persistently weak domestic demand", e.g. through further liberalization of the services sector and improving conditions for investment (p. 5).

– **Ensuring stability of the financial sector (Action 3)**

The Commission urges an accelerated restructuring of banks with the aim to safeguard "financial stability and underpin the provision of credit to the real economy". Public financial support for the banking sector is to be "gradually" withdrawn (p. 5).

► **Reforming labour markets**

"Reforms are needed to promote skills and to create incentives to work" to address the demographic challenges and the relatively "low utilisation of labour" (p. 5).

The Commission's aim is to achieve an employment rate of 75% by 2020.

– **Promote employment (Action 4)**

- In order to promote employment, Member States should make work more attractive to second earners by tailoring tax benefit systems, making work arrangements more flexible and improving childcare facilities.
- In addition, the tax burden on labour should be eased in order to "stimulate demand for labour" and to combat undeclared work (p. 6).

– **Reforming pension systems (Action 5)**

In order to achieve a "fiscal consolidation" of the pension system aimed at sustainability (p. 6), Member States should:

- increase retirement age and link it with life expectancy;
- reduce early retirement schemes and set incentives to employ older workers;
- include demographic change into their pension policy decisions;
- support private retirement planning [cp. Green Paper on pensions COM(2010) 365; see CEP Policy Brief].

– **Getting the unemployed back to work (Action 6)**

Member States should design their social security schemes in such as way that:

- the unemployed on drawing benefits are given incentives to search for jobs, by limiting the duration of benefits and by conditionally linking training and job search more closely to benefits;
- "work pays" through "greater" coherence between the level of income taxes and unemployment benefits;
- unemployment insurance systems are adapted to the economic cycle, so that protection is reinforced during an economic downturn.

– **Security and flexibility on the labour market (Action 7)**

Employment protection legislation should provide workers with security but, at the same time, with flexibility on the labour market. To this end, Member States should:

- push back temporary and "precarious" contracts (e.g. mini-jobs and sub-contracted labour) in order to "improve employment perspectives for new recruits" (p. 7);
- simultaneously reduce "over-protection of workers" with permanent contracts, for instance through shorter notice periods and more flexible work time regulations;
- simplify the mutual recognition of professional qualifications.

► **Enhancing growth**

The Commission views the single market as an "important source of growth" and therefore advocates the further removal of existing obstacles to the single market (p. 7) [for further details see the Communication on the Single Market Act COM(2010) 608; see CEP Policy Brief].

– **Tapping the potential of the single market (Action 8)**

The Commission wishes to:

- advance the "further opening of the services sector";
- remove obstacles to cross-border e-commerce;
- propose a legal act relating to ICT standards (information and communications technology);
- remove tax rules restricting cross-border trading and direct investments and propose an EU-wide coordinated taxation of the financial sector;
- reform the VAT system and propose a common consolidated corporate tax base.

– **Mobilising private capital (Action 9)**
  - The Commission wishes to introduce "EU project bonds" in order to facilitate access to finance on capital markets for European investment projects, in particular in transport, energy and ICT; these "innovative financing instruments" are to be taken account in the forthcoming EU Financial Framework of 2014 [for further details see the Communication on the Single Market Act COM(2010) 608; see CEP Policy Brief].
  - The Commission wishes to facilitate "access to finance for SMEs and innovative start-ups" by enabling venture capital funds to operate freely throughout at cross-border level.

– **Energy supply (Action 10)**
  Energy prices are a key cost factor for business and private households. To this end, the Europe 2020 strategy aims at a 20% increase in energy efficiency.
  - Member States should implement quickly the third internal market energy package (see CEP Overview on the third energy package).
  - Member States should step up their energy savings in order to reach the energy efficiency targets (see CEP Standpoint on European Energy Policy, in German).
  - The Commission signals initiatives for the improved development and cross-linking of transport, energy and telecommunications [for further details see Communication on the Single Market Act COM(2010) 608; see CEP Policy Brief] .
  - The Commission is developing EU-wide standards for energy efficient products (implementation of the Ecodesign Directive 2009/125/EC; see CEP Policy Brief, in German).

Policy Context

The Communication is accompanied by the progress report on the implementation of the Europe 2020 strategy, a macro-economic report and a draft joint employment report. On 15 February 2011, the EU finance ministers discussed the Annual Growth Survey and adopted conclusions which are in line with the Communication's content. On 24/25 March 2011, the European Council will adopt Guidelines serving as a basis for the Member States' Stability or Convergence Programmes and "National Reform Programmes". By the beginning of July 2011 at the latest, the European Council will issue country-specific policy guidance on national economic and budget policies.

Options for Influencing the Political Process

Leading Directorate General: Secretariat General

ASSESSMENT

Economic Impact Assessment

The "European semester", whose commencement is marked by the first Annual Growth Survey, reinforces the coordination of economic policies in the EU. Instead of simply defining economic and fiscal targets, as has been the case until now, the Commission is now suggesting to national governments additional concrete measures with which these targets are to be met. In principle, the proposed "key measures" are appropriate for reducing the indebtedness of Member States and increasing their competitiveness. However, somewhat problematic is the fact that this procedure slows down institutional competition between Member States; a particular risk is that Member States might use the coordination of economic policies to push for levelling to an average. Of course, these concerns are eased by the fact that the proposals made constitute non-binding recommendations. In detail, the ten "key measures" are to be assessed as follows:

Budget consolidation: In the course of the financial and economic crisis, the Member States' public deficits and indebtedness increased dramatically. **The statutorily prescribed** annual **reduction of the structural deficits** by 0.5 % of GDP (Art. 3 (4) VO 1467/97) **in many cases does not suffice to ensure the sustainable financing of state budgets** in the medium-term. **Therefore, Member States should push for consolidation beyond the statutory requirements**.

In order to increase state revenues, the Commission's proposal to increase indirect taxes is something to consider. For empirical studies demonstrate that an increase in indirect taxes is normally less harmful to growth than an increase in direct taxes. The impact of increased indirect taxes on work and investment incentives is less negative, as usually they constitute consumer taxes. **Some indirect taxes**, such as energy taxes, however, **increase economic production costs** and thus decrease the global competitiveness of companies. **The suggestion that an increase in indirect taxes is preferable is therefore too general**.

The proposed broadening of tax bases is preferable to increasing tax rates, since efficiency losses increase disproportionately with higher tax rates.

The Commission should, however, **pay more attention to the fact that reducing public expenditure is generally more growth-friendly than increasing state revenues.**

Correcting macro-economic imbalances: The euro-crisis clearly demonstrated that macro-economic imbalances in the form of current account imbalances are not acceptable in the long term and that they jeopardize the stability of the eurozone. Therefore, eurozone countries with a structural current account deficit – which necessarily goes hand in hand with a demand for credit that can only be covered by foreign capital – should accomplish competition enhancing reforms, primarily real wage reductions. Otherwise, the indebtedness of these economies will continue to rise. As the automatic adjustment of wages to inflation makes wage reductions almost impossible, the Commission is right to see a need for amendment here.

States with a current account surplus may also be in need of reforms, since such a surplus is always accompanied by the same amount in capital export; these countries often **have a low investment ratio and low growth**. **Therefore**, affected **euro states should**, as the Commission urges, **improve their investment conditions**. Besides, increased investment activity means an increase in domestic demand.

Stabilising the financial sector: Public financial aid for the banking sector poses a great risk to the fiscal policy of Member States. Moreover, it distorts competition between banks. To this end, the Commission's recommendations should be followed. As long as the "too big to fail" issue is not solved, there is no alternative to public financial aid.

Promoting employment and getting the unemployed back to work: **The Commission's proposals to promote employment and to get the unemployed back to work are generally appropriate for reducing unemployment**. The suggestion that work should be made more attractive to second earners by tailoring the tax system to meet their needs – what appears to mean is abolishing the splitting tariff for married couples – ignores the fact that the aim of having different tax classes for married people is to ensure neutrality when deciding the allocation of responsibilities in families. Of course, the option that both spouses work should not fail because of lacking childcare facilities. The **concept of flexible working hours is** however **limited by operational needs; any legal claims to family-friendly working hours therefore lower economic efficiency and with that employment.**

Reforming pension schemes: Pay-as-you-go schemes require ever-higher contribution rates or state aid due to demographic change. In Germany, that amounts to almost 80 billion euro per year. By way of comparison: Germany's budget deficit in the crisis year 2009 was 73 billion euro; hence, there is substantial need for reform. The Commission's proposals are altogether appropriate for neutralising the demographic effects on pension schemes [cp. CEP Policy Brief on the Green Paper on Pension Schemes [COM(2010) 365].

The proposals regarding security and flexibility on the labour market merely reiterate the already known position of the Commission, as described in detail in the Communication on Europe's contribution to full employment [COM(2010) 682; see CEP Policy Brief]. The same applies to the recommendations regarding the tapping of the potential of the single market and mobilizing private capital [see the Communication on the Single Market Act COM(2010) 608; see CEP Policy Brief]. The Commission's proposals regarding energy supply are in line with the measures pointed out in the Communication on Energy Infrastructure [COM(2010) 677; see CEP Policy Brief] and the Ecodesign Directive 2009/125/EC (see CEP Policy Brief, in German).

Legal Assessment

Legislative Competence

The EU has the power to recommend to Member States guidelines for economic policies, to monitor these guidelines and to issue warnings and country-specific recommendations (Art. 121 TFEU – Economic Policy Guidelines). It may also coordinate and monitor the budgetary compliance specific to the euro-states (Art. 136 TFEU – Functioning of the Economic and Monetary Union).

Subsidiarity

Any supranational coordination of economic policies of several Member States can be carried out at EU level only. Exchange rate adjustments as a reaction to macro-economic trends are not possible within the eurozone. As a consequence, the economic policy of one Member State affects the real economy of other Member States.

Conclusion

As the reduction of structural state budget deficits prescribed by EU legislation does not suffice in many cases, Member States should reinforce their consolidation efforts. The recommendation that increasing indirect taxes is preferable is too general. The Commission should pay greater attention to the fact that reducing public expenditure is more growth-friendly than increasing taxes. States with a current account surplus should improve their investment conditions as proposed by the Commission. The Commission's proposal to promote employment is appropriate; any legal claims to family-friendly working hours, however, reduce economic efficiency and thus have a negative impact on employment.