Fiscal Challenges in Europe

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Much progress – but significant remaining challenges

- Public debt: rise not yet tamed
- Competitiveness: gradual recovery
- Private sector debt: still notably high
- Monetary policy: still expansionary
- Institutional rules: strengthened, but implementation is key
Economic Situation Germany

• GDP growth 2014 revised upwards to +1.6 %, strong last quarter (+0.7 %) buoyed by consumption and investment
• Government projects 2015 growth cautiously at +1.5 %
• Strong labour market, record employment of more than 42½ million people
• Unemployment rate projected to fall further to 6.6 %
• Projected wage growth more than 3 % in 2015
• Favourable macro conditions: low oil/energy prices, lower external value of euro, record low interest rates
Economic Situation Germany

Unemployed persons and employees

Source: Federal Employment Agency
Internal demand becoming exclusive growth driver of German economy

Source: Federal Statistical Office; Germany's government annual forecast (28.02.2015)
Fiscal Situation Germany

- Since 2012 balanced budget of general government (Bund, Länder and municipalities)
- Federal Government balanced budget in 2014 - for first time since 1969!
- Fiscal stance slightly expansionary, economic growth above potential of + 1 ¼ %
- Focus: Improving the quality of budget. Shifting expenditure to investments: R&D, education, digital infrastructure.
Germany: Fiscal consolidation and increase in public investment at the same time

- Fiscal Balance in % of GDP
  - 2005: -3.3%
  - 2014: +0.4%

- Gross Investment in % of Public Spending
  - 2005: -3.3%
  - 2014: +5.1%
Economic Situation Eurozone

- All euro area member states back to growth, aggregate euro area GDP +1.3 % in 2015
- Unemployment coming down: euro area end of last year 11.4 %, lowest ratio for 2 ½ years
- Growth above potential growth of 0.7 %
- Regaining competitiveness, rebalancing of external accounts
Current account balances converging

Current account balance in % of GDP

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**Source:** EU COM Autumn forecast 2014
Example: Debt ratios still high

Source: EU database Ameco, Feb. 2015.
Fiscal Situation Eurozone

- **Austerity?**

  Huge progress: average budget deficit in euro area cut in half from 2010 (6.1%) to 2013 (2.9%); debt levels stabilised but at historic heights

- 11 member states still in excessive deficit procedure

- Only limited cross country fiscal spill-overs

- Large role of automatic stabilisers in euro area

- Need to keep demography in mind!
Going forward: Demographic challenges

### Age-related spending (in % of GDP)

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<td>UK</td>
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Fiscal Situation Eurozone

• Reforms and consolidation no trade-off but complements
  – Fiscal consolidation to contain public debt, structural reforms for competitiveness – not separate issues!
  – Governments need to tackle inefficiencies in labour and product markets, economic regulation, public service
  – Reform & consolidation packages to regain confidence of investors and consumers

• Reforms pay off: Spain, Portugal, Ireland - possible to reform and consolidate!
No trade-offs, but two sides of the same coin

Source: EU database Ameco, Feb. 2015.
Fiscal Situation Eurozone

• Investment plan for Europe: Not investing for the sake of quick stimuli...

• ...EU agreement on three pillars: sound public finances, reforms to overcome investment obstacles, fund for strategic investments (EFSI)

• Public expenditure ratios high, large state sectors in crisis countries

• Focus: framework, regulatory environment for investment needs to be improved
Europe after the crisis: What has been achieved?

- IRE, ESP, PRT programmes concluded
- Contagion contained, financial sector stability and resilience
- Confidence, market access regained
- pan-European efforts: Greece, EFSF, ESM – 800 billion Euro firewall + banking union
- European Solidarity of historical dimensions
Fiscal regime in Europe

• Rules-based system with flexibility. It can work! Strengthened and proven in crisis. Needs political commitment.

• 3% and 60% Maastricht values important for political communication.

• Also, balanced budgets (MTOs, constitution).

• Need to improve governance as to enforce fiscal rules and fiscal discipline. Financial, legal, political sanctions?
Fiscal future of Europe

Discussion: Need for Eurozone budget/spending?

• Volume of common EU spending low (structural/cohesion funds)

• Recent European Court of Auditors Annual Report: error rate of almost 5 per cent for EU spending!

• Only little welfare effect of EU spending, urgent need to improve efficiency/quality of spending!

• Common funds or budgets or common debt – for which purpose, democratic control?
Solidarity within Germany and Europe similar

Fiscal transfers in % of GDP

Notes: a) Saarland and Bremen: federal and state current and capital transfers + fiscal equalization transfers
b) Greece and Portugal: Operating budgetary balance
Fiscal future of Europe

Fiscal union far away...

- No one-sided look at fiscal spending only!
- Europe lacks common tax base, no harmonisation so far, also labour market institutions and social security systems – long way to go.
- Take political economy into account: different levels of private wealth, state assets...
A German view on Eurozone

• Go for clear-cut common institutions: rescue mechanism, banking supervision, monetary policy.

• Enhance Common Market, implement Banking Union, develop Capital Market Union.

• Look for bottom-up solutions, not just top-down solutions.

• Foster reform policies in Member States: e.g. public administration, digital economy, vocational training system …
A German view on Eurozone

Put more attention to privatisations. Consistent objectives:

• Modernising state-owned companies
• Motivating structural and regulatory reforms
• Creating favorable conditions for more private investment
• Improving government finances and reducing gross public debt