



Fiscal Challenges in Europe

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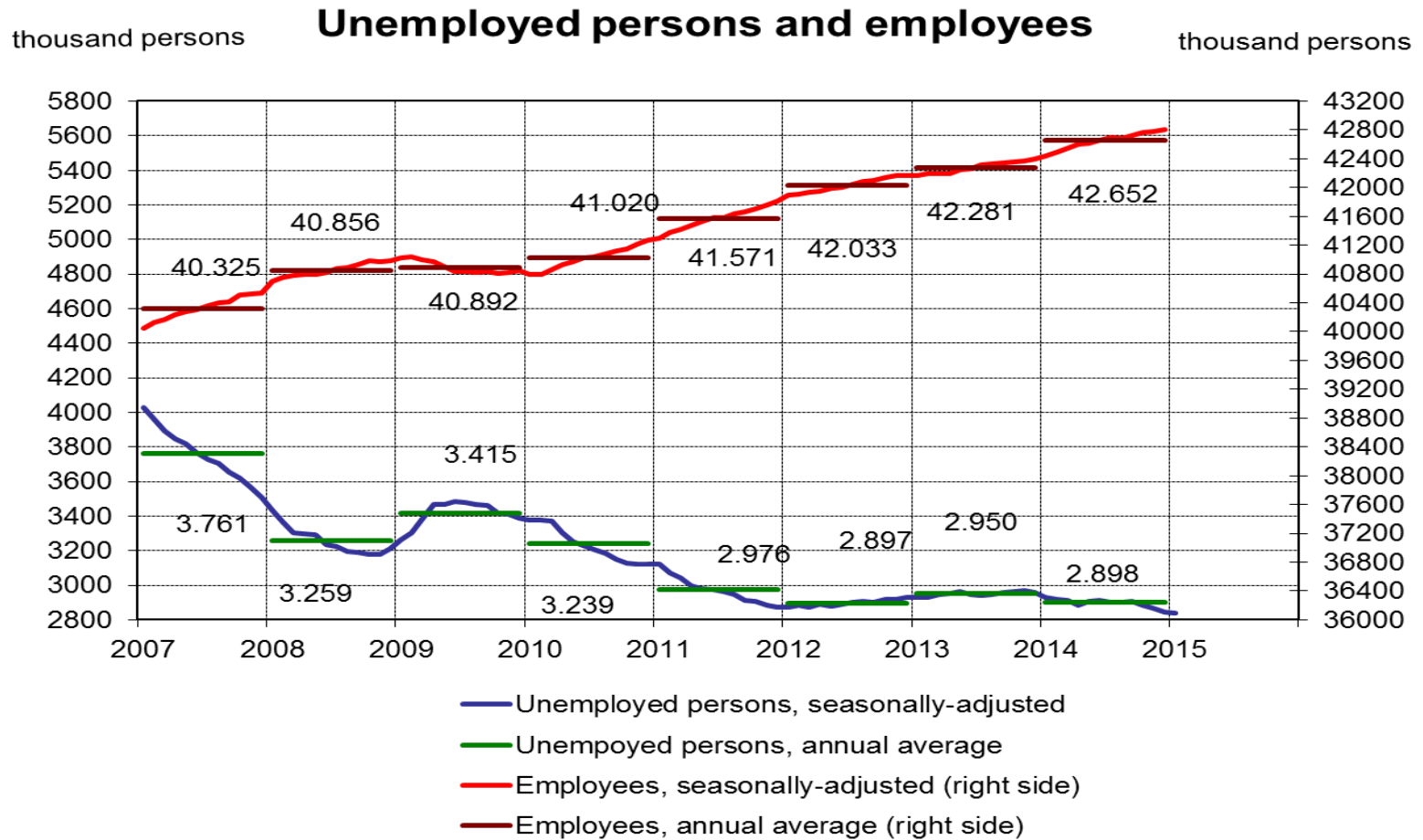
Much progress – but significant remaining challenges

- 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 42 ½ 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

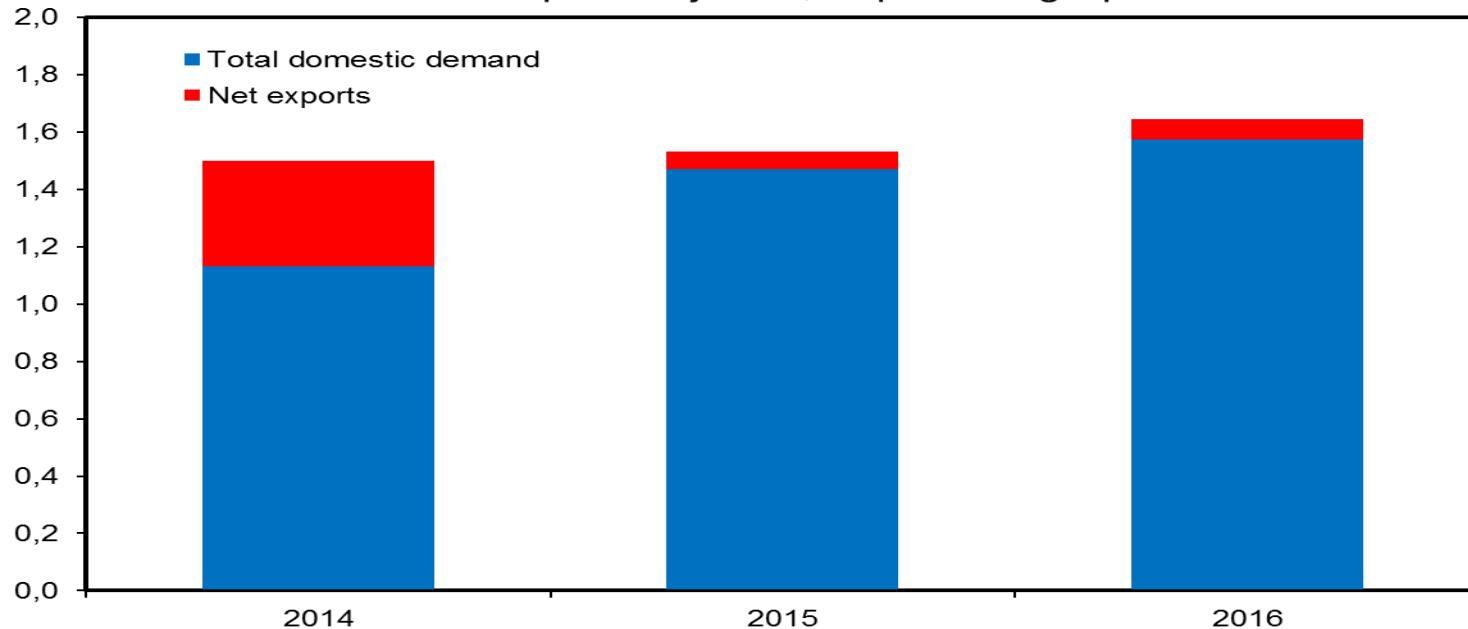


Source: Federal Employment Agency



Internal demand becoming exclusive growth driver of German economy

Components to growth, Germany
price adjusted, in percentage points



price adjusted increase compared to previous year in percent

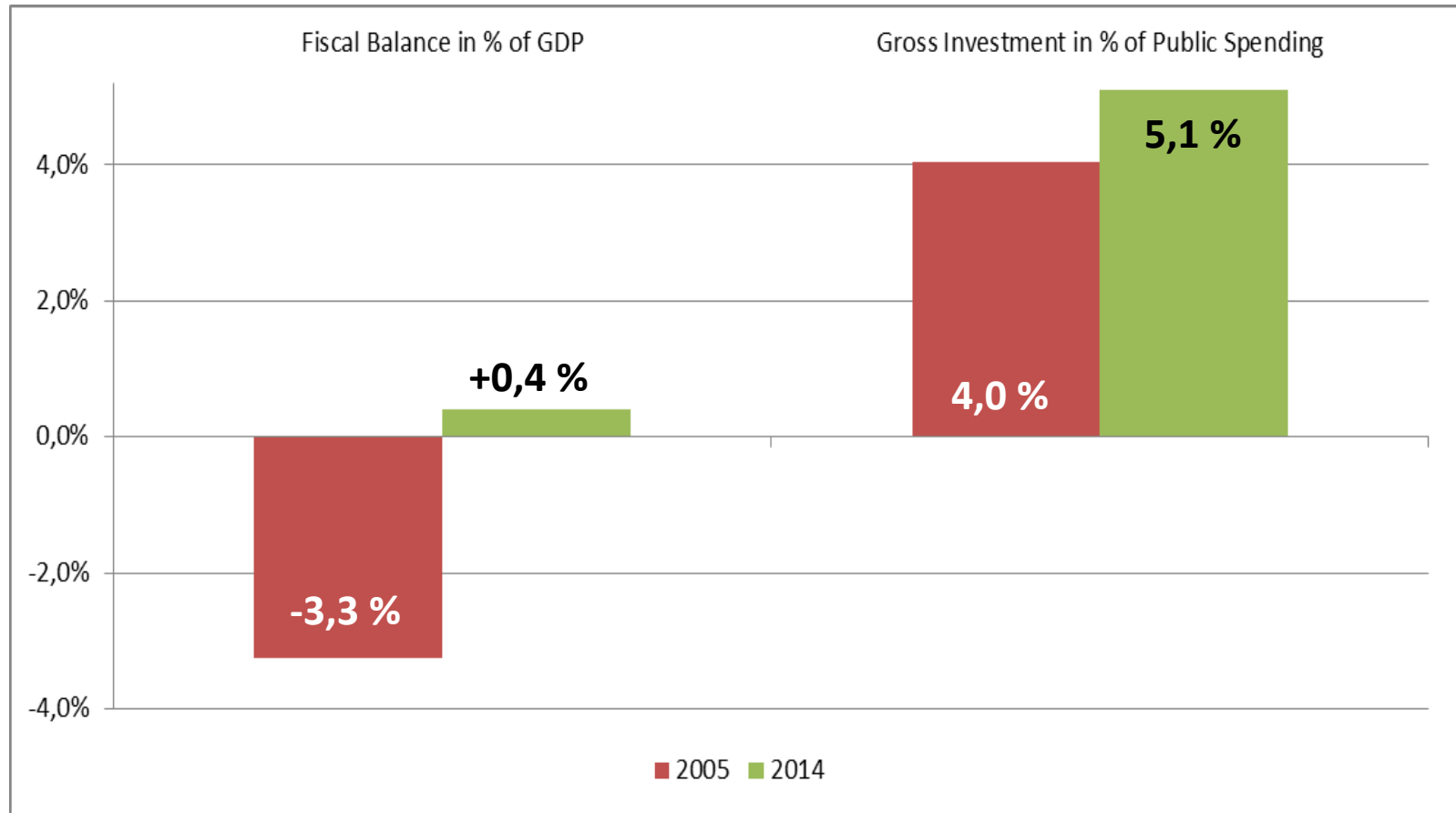
	2014	2015	2016
Private consumption	1.1	1.6	1.5
Gross fixed capital formation	3.1	2.1	3.0

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



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

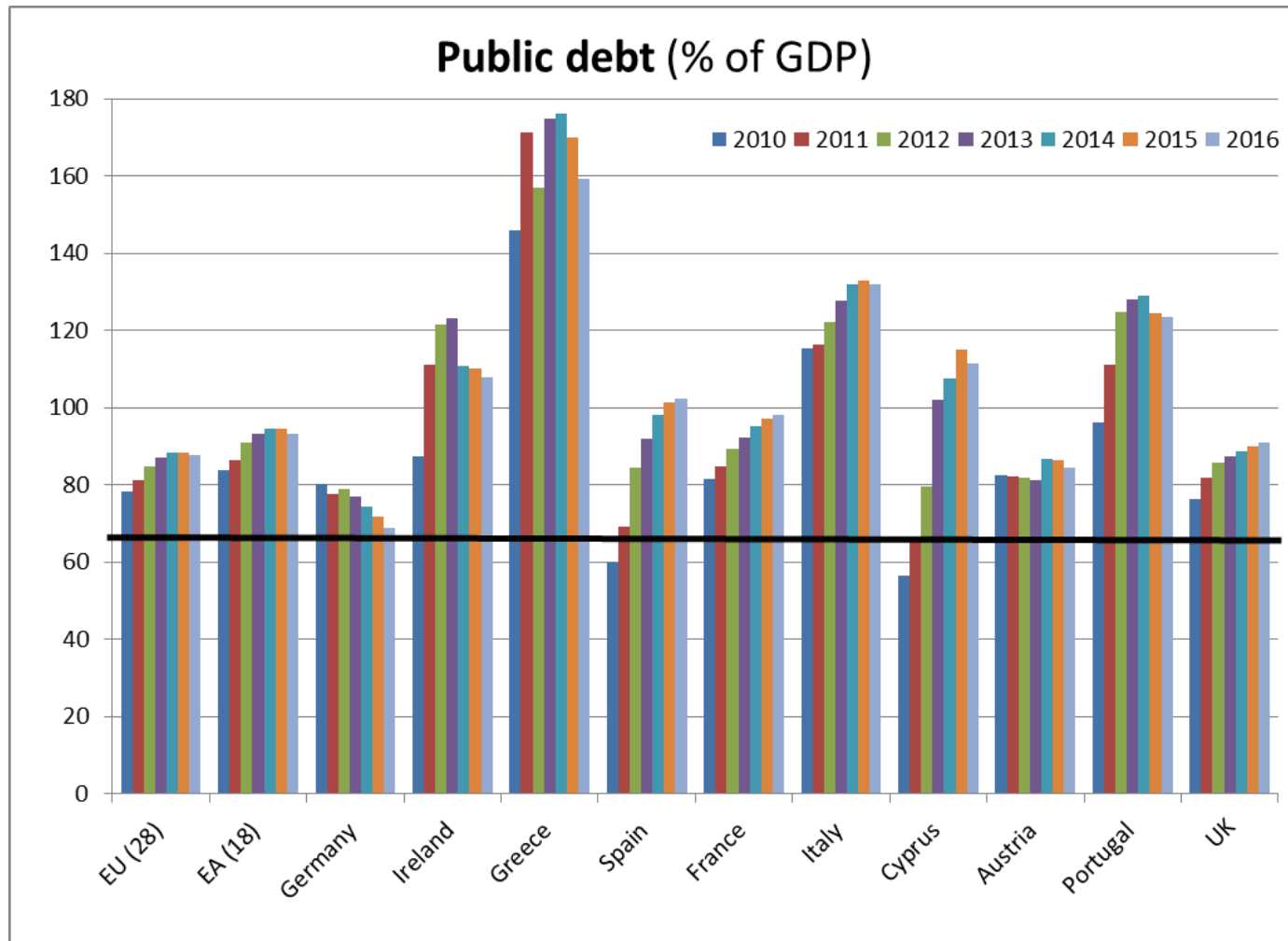
Current account balances converging

Current account balance in % of GDP

	1999	2007	2014	2015	2016
Euro area	0.28	0.29	2.54	2.62	2.52
Germany	-1.39	7.03	7.09	7.09	6.73
Ireland	0.16	-6.14	5.49	5.46	5.27
Greece	-6.80	-15.77	-2.82	-2.50	-2.19
Spain	-2.75	-9.64	0.48	0.71	0.95
France	2.74	-1.06	-1.91	-1.86	-2.18
Italy	0.79	-1.42	1.47	1.54	1.75
Ad memoriam: United States	-2.97	-4.96	-2.59	-2.68	-2.79

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)

EU Ageing Report 2012				EU Ageing Report 2009	
	Level 2010	Level 2060	Change 2010-60	Change 2010-60	
EU 27	26.0	29.7	3.7	4.6	
Euro area	27.0	31.1	4.1	5.1	
Germany	25.2	30.4	5.2	5.1	
Ireland	24.9	30.3	5.4	8.7	
Greece	25.9	28.8	2.9	16.0	
Spain	23.6	27.5	3.9	8.3	
France	31.4	34.5	3.1	2.2	
Italy	28.6	28.5	-0.1	1.6	
Cyprus	17.5	25.9	8.4	10.7	
Portugal	26.0	26.1	0.1	2.9	
Slovenia	23.8	34.1	10.3	12.7	
UK	22.1	25.4	3.3	4.8	

Sources: EPC Ageing Report 2012. EPC Ageing Report 2009

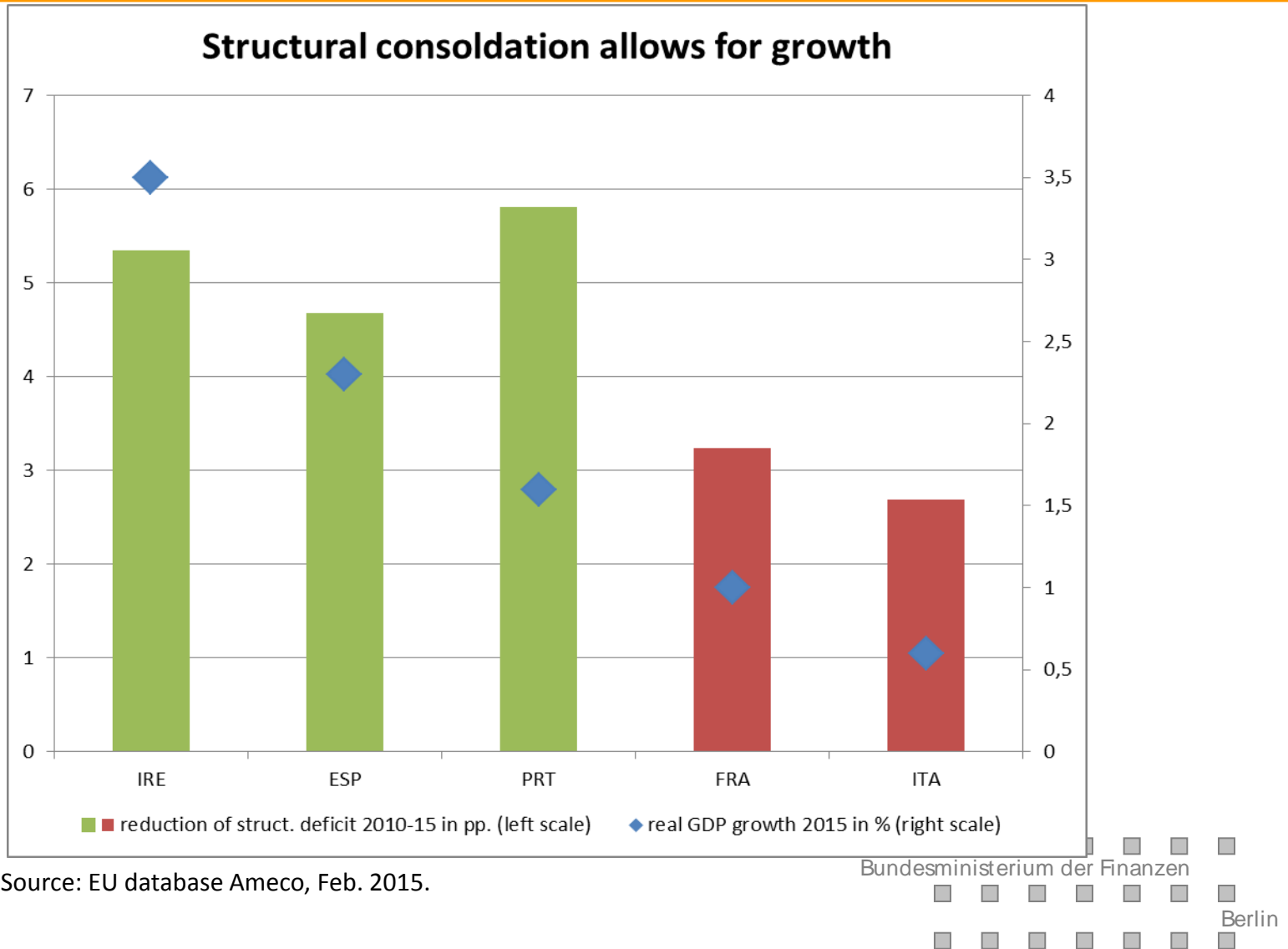
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OECD (2002) estimate for 2000-2050 increase US: 5.5. Japan 3.0. Canada: 8.7%/GDP.

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



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

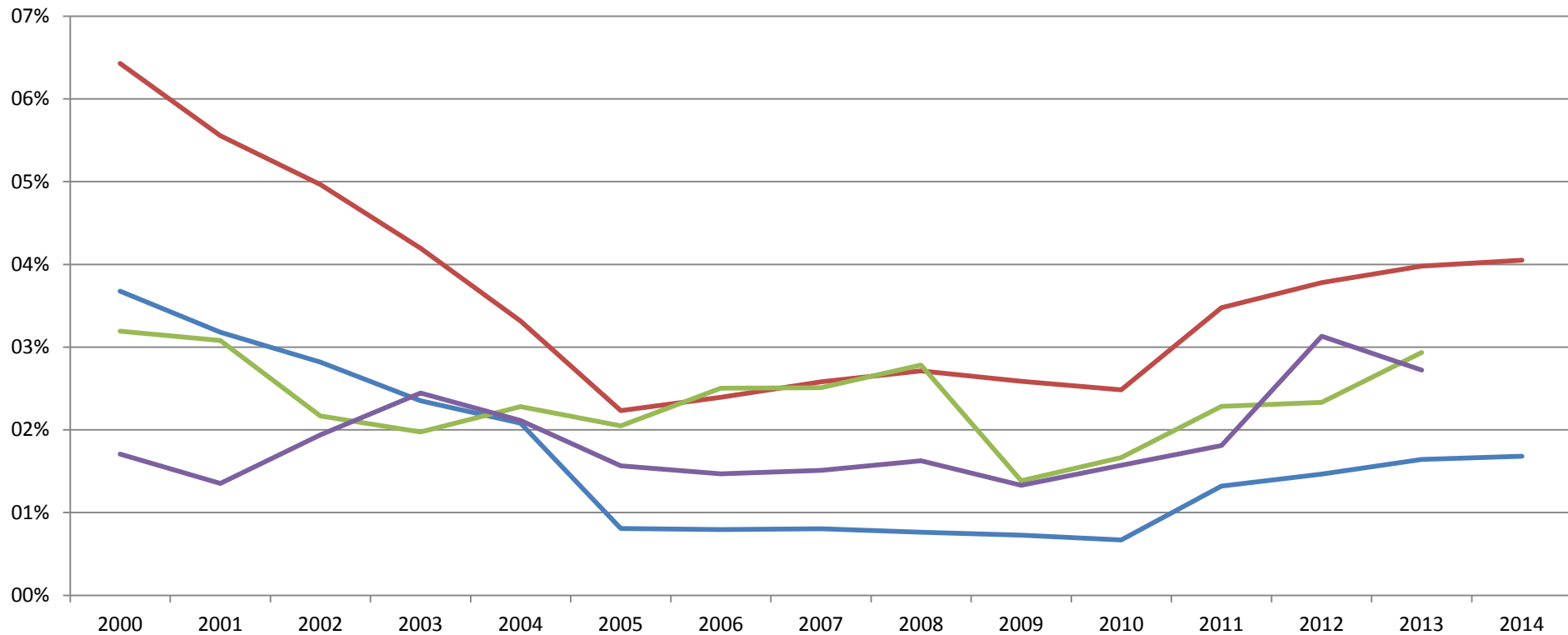
Discussion: Need for Eurozone budget/spending?

- 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

Saarland Bremen Greece Portugal



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