Lyon 2006 - Background papers and conclusions

EIN Summer University and European Ideas Fair

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EIN POLICY ROUNDTABLE

Economic, Monetary and Fiscal Policy

Background

Not least because of adverse demographic trends in Europe, sustainable fiscal policies are more urgent and necessary than ever. Fiscal prudence, low borrowing, efficiency in spending and sustained supply-side reform are essential to containing deficits, boosting productivity, and increasing growth and so living standards in Europe. EU member states need to accept clearly their responsibility for sound fiscal policies and for fulfilling the objectives and obligations they have undertaken in the Stability and Growth Pact (SGP).

Over the last four years, the EIN working group on Economic, Monetary and Fiscal Policy has examined various aspects of these issues. It has taken the view that the European Central Bank (ECB) has so far proved a competent currency manager, but that it is sometimes too narrow in focus and needs to take greater account of the real economy when setting interest rates. The independence of the ECB is important in achieving price stability and laying the foundations for sustainable economic growth, although the Bank should publish more detailed accounts of its internal policy debate.

For a common monetary policy in the eurozone to be successful in the long-term, more market liberalisation, deregulation and competition are essential. A successful, functioning currency requires labour and product market flexibility. A lower tax burden, based on competition rather than harmonisation, would spur economic growth. Europe's high tax burden is an important barrier to global competitiveness. Tax levels and structures need to be viewed in a global context - relative to both Asia and the United States.

On fiscal policy, the WG sees fiscal prudence and sound public finances as fundamental principles which should apply equally to all member states. EU institutions should not become scapegoats for failure by member states to meet fiscal criteria. The existing 3% budget deficit limit is sufficient, although the economic cycle should be taken formally into greater account. EU member states must ensure that government debt levels are driven down to and remain below the 60% limit, with the SGP serving as a driver of structural economic reform.

During the 2005 EIN summer university in Lisbon, the WG focussed on the liberalisation of financial services and felt that a single, monolithic approach would not be appropriate. Retail and wholesale financial businesses require different regulatory treatments, with information asymmetries in the former justifying legislation to protect consumers. More integrated financial and capital markets should lead to greater cross-border consolidation among financial services providers, although rising protectionism is a cause of great concern.

In June 2006, the WG met in Brussels to assess progress towards the completion of the European single market generally. Particular attention was paid to how to improve competitive bidding in public purchasing and research projects across national boundaries, to solve the problem of 'gold-plating' of EU regulations by member-state authorities, and to perform effective cost-benefit analyses and impact assessments before new regulations are proposed.

Conclusions of Lyon Discussion

Single European Market and productivity

The Single European Market (SEM) is not functioning effectively. This is a major factor behind Europe's under-performance in terms of productivity, technological innovation and wealth creation vis-à-vis the US and leaving it ill prepared to meet the Asian challenge. The SEM remains too fragmented (energy, financial markets and services) and competition is constrained to the detriment of consumers. A new, far-reaching services directive is required.

The SEM's shortcomings are reflected by stubbornly high unemployment and a disappointing productivity performance. Europe's less unfavourable performance in terms of productivity per worker provides little solace as diminishing marginal returns mean any pick-up in job creation is likely to be associated with declines in measured productivity.

Rising protectionist sentiment in Europe, especially evident in cross-border mergers & acquisitions, poses a major threat to the functioning of the SEM. Similarly, European governments must demonstrate a greater commitment to global free trade.

Taxation

Tax systems in Europe are increasingly anachronistic, typically characterised by a combination of high tax rates alongside multiple exemptions/reliefs. This induces major inefficiencies, distortions and a misallocation of resources.

Policymakers are faced with a clear choice: lower tax rates must be accompanied by zero exemptions for special interests.

Market-based tax competition is infinitely preferable to bureaucratically imposed tax harmonisation. It is inaccurate and damaging to depict such tax competition as 'social dumping' – rather, it is a fundamental feature of an effective market economy – and policymakers must stand up to vested interests that oppose liberalising tax reforms.

There is a case for placing more emphasis on reducing taxes on income (to bolster work incentives), shifting more of the burden to consumption. European tax systems have become ‘too progressive’ – protecting established interests at the expense of new wealth creation.

Action is also required to address unfair tax practices. More needs to be done to ensure that companies’ tax payments relate to where their business is actually conducted and where they are making use of public infrastructure (everything from transportation networks to the education system). Support was expressed for a system modelled on the US apportionment formula (tax relates to where companies’ actual activity, employment and investment occurs).

R&D and venture capital

There is no shortage of venture capital in Europe – this is not hindering new business start-ups. Rather, surplus capital raised in Europe is flowing overseas because of inadequate investment opportunities at home. The main deficiency in Europe relates to human capital – and the competitive challenge from Asia (notably from India) is likely to intensify.

The Lisbon Agenda included calls for more research and development (R&D), but pumping more money into R&D will not solve the problem. Rather, the requirements are for more investment opportunities and tertiary education reforms to reduce the current misallocation of human capital.

There is no true European internal market in the field of venture capital – national vested interests predominate. Legislative changes and competition policy are necessary to open R&D markets and allow capital to flow more freely within the SEM