

Warsaw 2007 - Background papers

EIN Summer University and European Ideas Fair

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EIN POLICY ROUNDTABLE ON

ECONOMIC, MONETARY AND FISCAL POLICY

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Background

The European Central Bank (ECB) has so far proved a competent currency manager. Introducing the euro in 1999 was the most far-reaching change in the international monetary system since the changeover to floating exchange rates in the early 1970s. Where the deutschmark and the yen failed in the early 1970s and 1980s, the euro appears to succeed - namely in challenging the dollar as the undisputed leading international currency. The euro has gained considerable clout as an international trade, investment, anchor and reserve currency over recent years - firmly establishing itself as the number two behind the US dollar. Recently, the US dollar held near record lows against the euro, as data showed the US economy feeling the strain from the housing slump and credit squeeze.

Over the last four years, the EIN working group on Economic, Monetary and Fiscal Policy has examined Europe's fiscal prudence, low borrowing, efficiency in spending and sustained supply-side reform. The objectives and obligations of the Stability and Growth Pact (SGP) remain valid, though the ECB could take more account of the real economy when setting interest rates. ECB independence is important in achieving price stability and sustainable economic growth. But above all, a lower tax burden based on competition not harmonisation would spur economic growth and remove an important barrier to global competitiveness.

At the 2006 EIN summer university in Lyon, the policy roundtable focussed on the ineffective functioning of the Single European Market (SEM). This was seen as a major factor behind Europe's under-performance in terms of productivity, technological innovation and wealth creation vis-à-vis the United States - leaving Europe ill prepared to meet the Asian challenge. The SEM is too fragmented, with competition constrained to the detriment of consumers. The shortcomings are reflected in high unemployment and disappointing productivity. Europe's less unfavourable performance in terms of productivity per worker is of little solace, since diminishing marginal returns mean any pick-up in job creation is likely to be associated with declines in measured productivity.

EU decision-makers should focus on generating jobs and growth through lower taxes and sound finance. Participants noted Europe's increasingly anachronistic tax systems, typically characterised by a combination of high taxes alongside multiple exemptions - inducing major inefficiencies, distortions and misallocation of resources. Policymakers face a clear choice: lower tax rates accompanied by zero exemptions for special interests. Market-based tax competition is preferable to bureaucratically imposed tax harmonisation. Taxes on income should be reduced to bolster work incentives, shifting more of the burden to consumption. European tax systems are 'too progressive' - protecting established interests at the expense of new wealth creation.

In March 2007, the roundtable met in Paris with the Robert Schuman Foundation to analyse the future of monetary and fiscal policy. The meeting underlined the lack of market openness in the fields of energy and services. For the energy sector, the EU needs to establish interconnecting national networks to create a proper internal market. If the private sector is reluctant to invest in such strategic projects, then the European Investment Bank could pump-prime cross-border investments. Equally, structural funds could be used to stimulate investment. - Europe must also recognise that fundamental structural reforms entail winners and losers. To resume high growth, Europe has to embrace a strategy based on competition, education, investment and flexibility. Evidence shows that the information technology and globalisation waves of the 1980s have increased the growth potential of higher education in all OECD countries to foster innovation.

Five questions arising for possible discussion at this year's summer university in Warsaw are:

- ? Will the euro become the premier international currency by 2025?
- ? What impact will increasing commodity, fuel and food prices have on the EU economy?
- ? Can the Reform Treaty help Europe's economy by reducing regulatory burdens and red tape?
- ? Is Europe cross-border coordination capable of coping with a major banking crisis?
- ? Should the EU examine credit rating agencies, hedge funds and derivatives trading?