# Fiscal Policy beyond fiscal rules:
## Effective tax coordination and employment targeting

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**Discussion**

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I fully agree on the diagnosis made on the fiscal framework:

- The fall in corporate tax rates (and more generally tax rates)
- The austerity programmes,
- The neglect of (net) public investment

- These are all elements which exert downwards pressure on euro area growth.

- I will focus my discussion on providing a critical view on the proposals you make.
- This is a reformist and pragmatic set of proposals, which aims to improve european fiscal policy without causing a major change, without a 'break'. Is this realistic? Is this desirable?

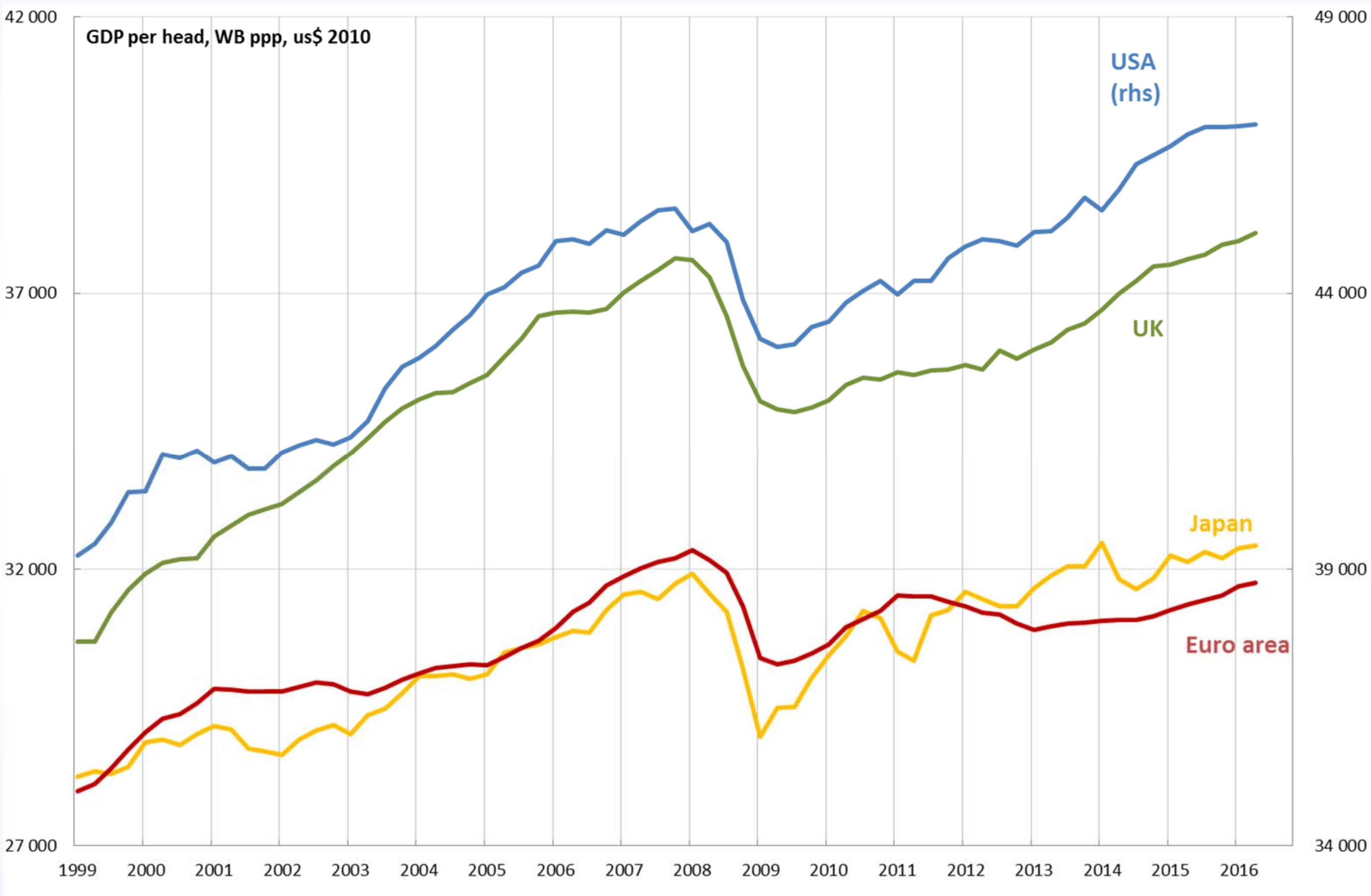
# 2015: GDP still below pre-crisis levels

*In %*

| | Trend GDP | Output loss in 2015 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|
| Germany | 1,6 | -6,7 | 3,4 | 0,8 | -5,6 | 3,9 | 3,7 | 0,6 | 0,4 | 1,6 |
| France | 1,8 | -11,9 | 2,4 | 0,2 | -2,9 | 2,0 | 2,1 | 0,2 | 0,7 | 0,2 |
| Italy | 1,2 | -18,3 | 1,5 | -1,1 | -5,5 | 1,7 | 0,6 | -2,8 | -1,7 | -0,3 |
| Spain | 2,4 | -24,2 | 3,8 | 1,1 | -3,6 | 0,0 | -1,0 | -2,6 | -1,7 | 1,4 |
| Netherlands | 2 | -14,9 | 3,7 | 1,7 | -3,8 | 1,4 | 1,7 | -1,1 | -0,5 | 1,0 |
| Belgium | 2,4 | -15,0 | 3,4 | 0,7 | -2,3 | 2,7 | 1,8 | 0,2 | 0,0 | 1,3 |
| Austria | 2 | -12,4 | 3,6 | 1,5 | -3,8 | 1,9 | 2,8 | 0,8 | 0,3 | 0,4 |
| Portugal | 1,8 | -20,9 | 2,5 | 0,2 | -3,0 | 1,9 | -1,8 | -4,0 | -1,1 | 0,9 |
| Finland | 2,4 | -25,7 | 5,2 | 0,7 | -8,3 | 3,0 | 2,6 | -1,4 | -0,8 | -0,7 |
| Ireland | 2,5 | -12,3 | 5,5 | -2,2 | -5,6 | 0,4 | 2,6 | 0,2 | 1,4 | 5,2 |
| Greece | 2,4 | -47,1 | 3,3 | -0,3 | -4,3 | -5,5 | -9,1 | -7,3 | -3,2 | 0,7 |
| | | | | | | | | | | |
| UK | 2,2 | -11,7 | 2,6 | -0,5 | -4,2 | 1,5 | 2,0 | 1,2 | 2,2 | 2,9 |
| US | 2,4 | -11,0 | 1,8 | -0,3 | -2,8 | 2,5 | 1,6 | 2,2 | 1,5 | 2,4 |
| Japan | 1,8 | -14,4 | 2,2 | -1,0 | -5,5 | 4,7 | -0,5 | 1,7 | 1,4 | 0,0 |

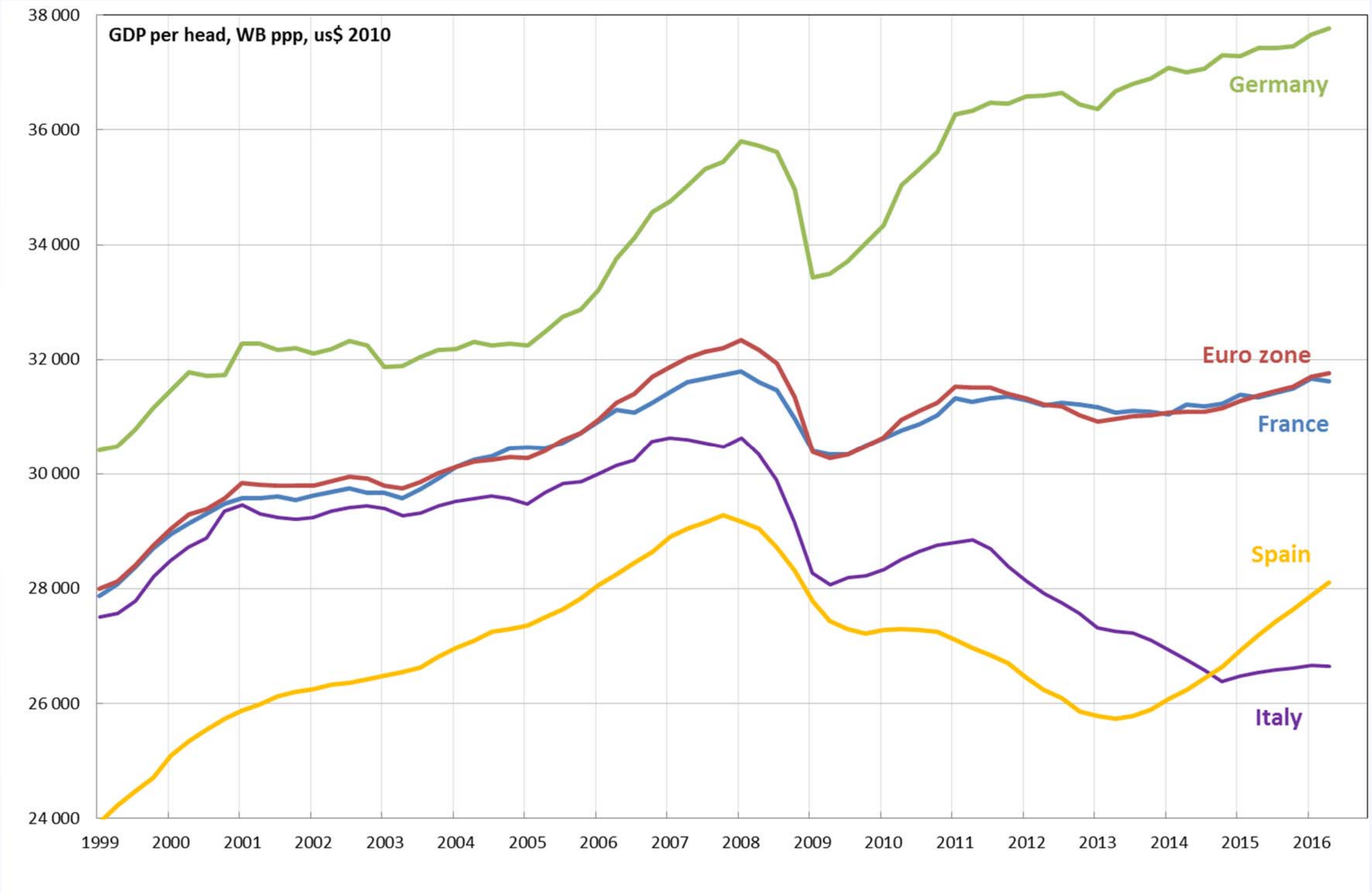
*Source: IMF, WEO April 2016, own calculations*

# GDP per head: euro area lagging behind…




*Source: National accounts, OFCE calculations*

# GDP per head within the euro area: uneven developments, even more since 2009




*Source: National accounts, OFCE calculations*

# Fiscal impulses (our estimates)

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total |
|---|---|---|---|---|---|---|---|---|---|
| Germany | 1,4 | -1.3 | -1,1 | -0,2 | -0.4 | -0.2 | 0.5 | 0.2 | -1.1 |
| France | 0,1 | -1,5 | -1.1 | -1,0 | -0.5 | -0.4 | -0.4 | -0.3 | -4.1 |
| Italy | -0.8 | -0.8 | -3.8 | -0.7 | -0.5 | -0.5 | 0.1 | 0.1 | -8.9 |
| Spain | -2,6 | -2.0 | -5.0 | -2.5 | -0.8 | 0.4 | -0.5 | -0.5 | -9.9 |
| Netherlands | -0.4 | -0.3 | -1.9 | -2.1 | -0.9 | 0.0 | 0.1 | -0.5 | -6.0 |
| Belgium | -0.5 | -0.4 | -1.2 | -1.0 | -0.3 | -0.5 | 0.4 | -0.3 | -3.8 |
| Austria | -0.2 | -1,1 | -1.4 | -1,0 | -1.2 | -0.7 | 0.5 | -0.2 | -5.3 |
| Portugal | -0.5 | -4,3 | -3,3 | -3.0 | -1,9 | -0,4 | -0,9 | -0,6 | -13.9 |
| Finland | 0,4 | -1,1 | -0,9 | -0.8 | -0,5 | -1.2 | -0.6 | -1.0 | -5.7 |
| Ireland | -2.3 | -1.8 | -2,4 | -2,2 | -1.2 | 0.1 | 0.2 | 0.1 | -8.5 |
| Greece | -7,5 | -7,4 | -5,8 | -3,8 | -0,1 | -2,4 | -1,3 | -1,4 | -29.7 |
| Euro area | -0.6 | -1.6 | -2,3 | -1,1 | -0,7 | -0.4 | -0.1 | -0.3 | -7.1 |
| U K | -1.4 | -1.8 | 0.1 | -0.8 | 0.1 | -0.7 | -0.8 | -1.2 | -6.3 |

- Slide 7: **ambitious “optimal“ institutionalised solutions?**

- **comprehensive tax harmonisation as a prerequisite?**
- **fiscal federalism in EU with a strong federal level?**
- refined system of fiscal equalisation?

**But:**

- is it really necessary?
- do we have to implement everything in constitutional rules?
- what about interdependence with wages and monetary policies and macroeconomic imbalances and industrial policy?
- **are there political risks of capture by the neoliberals?**
- how do we realistically get there?

## Slide 9: Directions for improvement

- **expansionary fiscal policy stance EU wide**
- **more countercyclical stabilisation**
  - more flexibility for national fiscal policies (combined with ECB support or debt relief)
    - Golden Rule of public investment
    - expenditure paths for non-cyclical spending
    - EU parliament participation in SGP decisions
    - abolish SGP?
  - more EU-wide automatic stabilisers („fiscal capacity“, unemployment insurance, EU budget)
  - But not substitution between the two!
- **Less rules and more macroeconomic policy coordination**
  - Upgrading of macroeconomic dialogue

- Slide 9: yes, of course, the SGP should be abolished together with the fiscal Treaty, otherwise no improvement can be implemented.
- No improvement can be expected also if the Commission does not change the way it calculates potential growth.

- The ECB should be a lender of last resort and guarantee public debts
- The unemployment insurance sheme is dangerous if it implies labour legislation to be implemented at the EU level

## Slide 10 Directions for improvement (cont.)

- **more rigorous fight against tax evasion**
- **more tax harmonisation**
  - give up principle of unanimity
  - Unified tax base for corporate taxation
  - Minimum tax rates
- **Financial transaction tax**

## Slide 12: 8 ways to boost fiscal policy and strengthen public investment

- You stick to the existing framework, and try to use ‘leeways’
- Time consuming to convince all EU authorities that these boosts can be made within the existing framework : invesment + expansionary overall fiscal stance
- Resulting boosts will be very small
- We should push for a new framework

# The Single currency's contradictions

- Economic policy coordination cannot consist in fulfilling automatic rules (like the SGP rules), and so a coordination process needs to be organised between MS.
- Coordination should target GDP growth and full employment; it should account for all economic variables; countries should follow an economic policy strategy allowing to meet the inflation target (at least to remain within a target of around 2%), to meet an objective in terms of wage developments (in the medium-run real wages should grow in line with labour productivity), in the short-run adjustment processes should be implemented by countries where wages have risen too rapidly, or not sufficiently; increases or cuts in social contributions may be used to facilitate the adjustment process (it must be noticed that the adjustment cannot bear only on minimum wages).
- As the targets are full employment, external balance and inflation rate, a target on public balance or public debt is not useful in this framework
- Countries should announce and negotiate their current account balance targets; countries running high external surpluses should agree to lower them or to finance explicitly industrial projects in Southern economies. The process should always reach unanimous agreement on a coordinated but differentiated strategy.

# The Single currency's contradictions

- The process should always reach a unanimous agreement on a coordinated but differentiated strategy.
- Public deficits resulting from this process should be financed through debt issuance guaranteed by all euro area countries and by the ECB.
- The new Treaty needs to maintain an effective process in the case where no agreement is reached. In that case, the new debt issued by countries outside the agreement would not be guaranteed; but this case should never occur.
- It is not so easy to define such a strategy. There were two main issues : the current account balance targets compatibility ; the need to adjust by wage evolutions coordination.
- We are aware that it would be difficult, if not impossible, to reach such an agreement, based on an intelligent and precise cooperation rather than on rigid rules. It would require negotiations with uncertain outcomes. But this is the only way for a currency area to work properly.
- If open economic policies cooperation cannot be run within the euro area, then the single currency will not survive.

- In this framework, the ECB should maintain the interest rate below the rate of growth to reduce the weight of the public debt. It should strongly encourage the banks to turn away from speculative activities (in particular through financial transactions taxation) to finance productive activities (in particular the re-industrialization and ecological transition).
- The euro area needs to regain the 10 percentage points of activity lost due to the crisis. This would make sustainable MS public debts and deficits. Abandoning this goal would mean accepting the persistence of European mass unemployment. European Institutions and MS should develop an economic strategy, based on the recovery of demand - consumption as public spending as private or public investments - and on a coordinated resorption of current imbalances.

- Can debt crisis exit strategies forget about the causes of the economic crisis? The crisis is due to growth strategies based on the pressure on wages and social benefits, the decline in demand offset by competitiveness gains in mercantilist countries, by financial and real estate bubbles and the growth of households' indebtedness in Anglo-Saxon and Southern countries.
- The failure of these strategies has lead public deficits to increase. Reducing these deficits can be done only after setting another growth strategy which should be based on the distribution of wages and social benefits as well on a new industrial policy, organizing and financing the turn towards a more sustainable economy.
- The difficulties of public finances before the crisis are due to tax competition policies. Restoring public finances should must be done through combating tax evasion and tax optimization, by preventing European firms and financial Institutions to use tax and regulation havens, by raising taxes on multinational corporations, on highest incomes and wealth.

- But governance in Europe will not improve if European authorities do not set the target to protect and to develop the European social model, if Northern countries do not to abandon the principles of governance by rules and by financial markets, if Member countries do not share a common project.
- Euro area's survival requires that the European project becomes popular, again, carrying a specific social model, an objective of convergence and solidarity among MS and a turn socially decided towards a development taking fully into account the ecological constraints. It is only within this framework that institutional progresses could be made.