Fiscal stimulus, control of the public debt and recovery from the crisis

Recommendations of the Economic and Social Commission
adopted by the Brussels Central Council (11 December 2009)

I - The Economic and Social Commission of the European League for Economic Cooperation, meeting in Paris on 13 October 2009, **took note** that:

(a) Fiscal stimulus measures, which remain vital for meeting an unprecedented economic crisis, came on top of persistent structural deficits in many countries, leading to unacceptable levels of public deficits (in the broadest sense: state + social security + local authorities). These deficits, which now exceed the Maastricht ceiling of 3% GDP in 20 of the 27 EU Member States, are likely to reach 6% of GDP on average in 2009, and probably 7.5% in 2010, despite the hoped-for return to growth;

(b) Such deficits, the result of excessive expenditure and of insufficient public savings and public resources (not least at a time when retirement pensions will represent an increasing burden), are provoking a rapid rise in public indebtedness, which is on track to reach an EU average of 70% of GDP by the end of 2009, and 80% at the end of 2010. It has already passed 100% of GDP in half a dozen EU countries. The foreseeable rise in long term interest rates runs the risk of making this debt grow exponentially (the snowball effect), and servicing it will become the first item of state expenditure in many cases; on average, the 27 EU Member States would have to improve their budgetary balances by 6% of GDP simply to stabilise the debt/GDP ratio;

(c) Markets' reaction to this excess of debt has so far been moderate, and is likely to prove inadequate to restore the necessary discipline. It has mainly been expressed in an increase of the "spreads" - additional interest charged as a risk premium on the loans of indebted countries, above the rate charged to the reference borrower (which remains the German Federal Republic). Spreads have tripled since the crisis began, and are now as high as 30 basis points for France and the United Kingdom, and more than 200 basis points for the most indebted countries... However, it is striking that the sovereign debt rating of several countries has been revised downwards - sometimes by several notches -reflecting concerns which may well deepen. It is no longer unthinkable that some EU countries might find it impossible to borrow further, as happened to Iceland - in particular for countries outside the euro zone which lack the implicit support of the ECB. (outside the EU, Iceland has provided an extreme example of this risk). The current situation, which is propitious to the issuance of government bonds, is transitional in nature, being due to the weak attraction exercised on savings by share markets and real assets (property in particular). This situation is likely to reverse as soon as the first signs of sustainable recovery appear, leading to great tension on the rates and spreads of public issues.

II - In view of this dangerous situation, the Economic and Social Commission of the League makes the following **recommendations**:

1. Measures for fiscal adjustment - which by necessity will have to combine spending cuts and revenue increases - cannot be fully implemented until the end of the crisis has been confirmed. However, serious preparations must be got under way immediately, and their necessity explained to public opinion to avoid any

complacency. It would be desirable to introduce legal rules as binding as possible, even constitutional ones, that would prohibit structural deficits and outline a roadmap and timetable for a gradual return to balance;

2. Combating cyclical depression by restarting public investments and through the "social security net" takes nothing away from the necessity of reducing structural deficits, in particular through programmes to rationalise public expenditure in order to improve its effectiveness, eliminate inappropriate subsidies, avoid over-manning and generally encourage the efficient management of resources;

3. These measures are all the more essential in order to avoid the risk of crowding out from the markets, through a rise in interest rates, private borrowers who will need to rebuild stocks, replenish staff, and invest;

4. The necessity of encouraging sustainable development is too little taken into account in current budgets and stimulus plans, which have only devoted around 15% of their amount to "green growth" (energy savings, clean technologies, protection of biodiversity, etc.). Priorities must be refocused in this direction, using practical measures which, far from being inevitably costly, can on the contrary - once they have been sorted and the most profitable retained - bring additional resources and create a welcome multiplier effect while encouraging better environmental performance;

5. A strategy for emerging from the fiscal crisis will be all the more effective if it is ambitious, going beyond the simple "golden rule" of balancing current income and expenditure, and "sequenced" in function of economic developments;

6. Solidarity between Member States, which is greater than is often thought, has been evident throughout the crisis; it has given beneficial results, and should be strengthened. Hence, exit strategies should be developed in close consultation between Member States.

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