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MOMENTUM FOR RECOVERY IN EUROPE
PROMOTING PUBLIC AND PRIVATE INVESTMENTS

Funding and financial ambitions for more growth in Europe

presented by Poul Nyrup Rasmussen on behalf of the PES Network on the Lisbon strategy

In Thessaloniki, in June 2003, the European Council endorsed "*the Commission's intention to launch an initiative in cooperation with the European Investment Bank to support growth and integration by increasing overall investment and private sector involvement in TENs and major R&D projects*". It called for this work to be taken forward under the EU Italian Presidency.

Member States share the objectives inspiring the European Commission's Initiative and, since Thessaloniki, have started to prepare concrete proposals for action. Italy presented its ideas before the summer of 2003, focusing primarily on reinforcing transport links. France and Germany, in a joint presentation in September 2003, confirmed their commitment to the Lisbon reforms and identified ten investment projects, grouped around TENs, R&D, and environmental and educational developments.

The European Commission presented its proposal (interim report) for a *"European Growth Initiative"* at the end of September 2003, highlighting and promoting certain key investment activities in the fields of TENs, telecommunications, R&D and technical innovation. This Initiative should provide further impetus to the Lisbon Strategy through addressing current gaps in Europe's physical and knowledge infrastructure, seeking to give a selected boost to investment, and improving the regulatory framework and public support in order to encourage businesses to innovate and invest. The "European Growth Initiative" represents a partnership for investment in networks and knowledge. Furthermore it should fully take into account investment in human capital, the environmental and sustainable development aspects, and it should promote the development of clean technologies, which offer important opportunities in terms of growth, employment and social welfare.

To this end the European Council in October 2003 endorsed the principles of the proposed "European Growth Initiative" and invited the relevant actors to take it forward along the lines set out it. However, the Initiative should be consistent with the Lisbon strategy and in line with the commitments in the

Broad Economic Policy Guidelines and in the European Employment Guidelines 2003-2006. In order to achieve the rapid progress necessary to make a definitive assessment of the Initiative and take concrete decisions at its December 2003 meeting, the European Council invited the Commission, the EIB and the relevant formations of the Council to establish a *"quick-start programme"* identifying a list of investment projects in an enlarged Union. At the same time, the European Council invited the Member States to complement the "European Growth Initiative" by *"national growth programmes".*

This paper is presented by the Socialist family as a contribution to the implementation of the "European Growth Initiative" and seeks to strengthen short-term confidence and to consolidate our potential for growth and employment. It is time for the European Council, Commission and the Member States to give a strong signal of timely economic governance in order to boost confidence, prevent the risk of a downturn and consolidate economic recovery.

Consequently, the main purpose of this paper is to present new ambitions for adequate funding instruments and financial support mechanisms for more growth in Europe. Furthermore it will show throughout an assessment of the economic effects and concrete calculations – documented in an annex to this paper – that the following funding and financial ambitions will help to achieve better the objectives of the Stability and Growth Pact and will promote the European-wide potential for growth and employment if measures will be taken in a co-ordinated way and timely together from all Member States.

The main question is now: How can we guarantee that, after the political go-ahead, the planned promotion of the potential of growth and employment will be achieved? The Socialist family would like to focus on a five short-term plan up to 2006 in order to keep all promises:

A FIVE-POINT PLAN

1. Mobilising European financing resources through full spending of the EU budget in line with the Lisbon objectives

- *to go beyond the current European-wide public spending limit of 0.8 % of GDP, whilst insisting that there is room for manoeuvre in spending between 1% and 1.27% of GDP 2004-2006 in line with the present financial perspective 2000-2006 and the Lisbon objectives as well as with the promotion of private investment activities;*
- *to have an "ambitious" spending limit and a major "redirection" of total expenditure between the various headings must better reflect the major political priorities set for 2010 through an initial heading entitled "growth, competitiveness and cohesion" containing all internal policy instruments and structural funds.*

2. A growth promoting European monetary policy

- *to avoid a deflationary situation right from the beginning of positive economic developments and to restore economic confidence at the same time by avoiding marginal interest rate cuts or even increased interest rates;*
- *to assess whether the present inflation target is optimal for growth in Europe.*

3. Strengthening the contribution of the EIB through full use of loan capacity

- *to increase the advisory and technical support of the EIB to Member States and to the private sector, in particular to SMEs, promoting development of PPPs both at policy and project level where appropriate as well as private investment;*
- *in line with the Lisbon objectives,* to *invest further in projects which, because of their characteristics, especially the risk and clean technology involved, cannot be funded by commercial banks and the capital markets by developing specific instruments to meet the needs of SME investment projects and risk-capital projects that exceed the global loan ceiling of the EIB.*

4. Redirecting national public expenditure towards the Lisbon objectives

- *to set up a clear method that includes a definition of 'high-quality public expenses' to quantify public budgetary positions and their contribution to growth and investment with a view to making a positive contribution to the Lisbon objectives*;
- *to link more closely the quality of public spending within the framework of the European Structural Funds with all Lisbon objectives during the second phase of the programme period 2000-2006 and should be comparable in all Member States.*

5. Better co-ordination of high quality public spending between Member States

- *to provide detailed information on the use of public spending as a contributor to sustainable economic growth, competitiveness, environmental sustainability and social cohesion* within the *national "growth programmes";*
- *to issue the national budgets and "growth programmes" at a common time during each year and with comparable information between Member States.*

1. Mobilising European financing resources through full spending of the EU budget in line with the Lisbon objectives

At the end of October 2003, the European Commission proposed that € 5 billion of unused appropriations in the framework of the implementation of the European Structural Funds from the 2003 EU budget, be returned to the Member States. It is unfortunate that Member States sent their final payment claims only at the last minute - and often they were incomplete so that the payments cannot be implemented as planned. This is certainly welcome for the national budget planning of the Member States, and will result in a substantial reduction of Member States' contributions to the EU budget. However, in this context we have firstly to stress that if the EU has new ambitions, such as the "European Growth Initiative", *we must go beyond the current European-wide public spending practise of 0.8 % of GDP, whilst insisting that there is an agreed spending limit of 1.27% of GDP 2004-2006 in line with the present financial perspective 2000-2006 and the Lisbon objectives as well as with the promotion of private investment activities.*

The financial perspective is a framework agreed by the European Parliament, the Council and the Commission laying down, subject to the ceilings on own resources assigned to the EU, maximum amounts by major heading of expenditure within which the annual budget must be established over the period in question. It translates into financial terms the priorities set for the Union's policies and is at the same time an instrument of budgetary discipline, and it also determines the limits on the financing of the EU budget. The classification of Community expenditure by financial perspective heading is based on a policy approach.

In view of the already ongoing discussion about the new financial perspective 2007-2011, the succession of budgetary rows prompted the Community institutions to agree on a method to improve the operation of the budgetary procedure while at the same time guaranteeing that budgetary discipline should be maintained. However, *an "ambitious" spending limit and a major “redirection” of total expenditure between the various headings must better reflect the major political priorities set for 2010.* We would therefore also stress the need to reorganise the various categories of the EU budget to accord greater priority to the implementation of the Lisbon strategy. This could entail the hypothesis of *an initial heading entitled "growth, competitiveness and cohesion" containing all internal policy instruments and structural funds.*

These proposals are based on an even more active role by public authorities at national and Community level in promoting private investment activities as well as creating growth and employment in Europe. It exploits any further room for manoeuvre offered by public resources at Community level within the current Financial Perspective in order to mobilise private funding for priority Community-wide private and public investment projects.

2. A growth promoting European monetary policy

In a system like the eurozone, monetary policy play a crucial role in stabilising growth and employment. The ECB, like any other economic policy actor, is confined to support the general goals of sustainable growth and full employment of the European Union and to make comments and to give advice in this respect. In any case, as soon as price stability is seen to be affected, the ECB can react to decisions by adjusting interest rates according to its view. The ECB has not in all aspects lived up to this responsibility, the slowness with which interest rates have been lowered during the downturn has been detrimental to European economy. The policy pursued by the American Federal Reserve has in this respect been more proactive, which has been beneficial for the US economy.

All indicators have pointed to a decision to lower interest rates more significantly. The outlook for growth is far below the ECB´s own estimate of potential growth, so that the output gap has increased. The strong growth of monetary aggregates has been correctly dismissed by the ECB as the consequence of insecurity in the stock markets, which has induced investors to shift their money into more short term assets. The ECB should be careful to assess the impact of public deficits correctly.

However, in future it is important that monetary policy in Europe from the outset vigorously combats deflationary tendencies. Therefore it is now time for monetary policy to avoid a deflationary situation right from the beginning of positive economic developments, and to restore economic confidence at the same time. In the current situation it is important that the still weak upturn is allowed to gather momentum before any tightening of monetary conditions takes place. This is especially important in the light of the strong appreciation of the euro, which risks hampering the much needed pick up in European growth. *This requires a responsible interest rate policy and not marginal interest rate cuts or even increased interest rates.* In the Euro area short term rates should go down. Then the expansionary impact of ECB monetary policy would be almost as strong as that of the FED.

Monetary policy in the Euro area is guided by the inflation target the ECB has set itself. This target is asymmetric and tighter than any other inflation target guiding central banks in other currency areas*. Five years after the launch of the euro time is becoming ripe for assessing whether this inflation target is optimal for growth in Europe.* The ECB must make a stronger contribution to a global recovery, which has its roots also in the Euro area, through a monetary policy which promote growth and employment in Europe.

3. Strengthening the contribution of the EIB through full use of loan capacity

The EIB plays a major role as a stabiliser during economic slow-downs. Projects account for some 5% of total investment in the EU and are estimated to generate each year some 380 000 jobs in the development of infrastructure and 40 000 jobs in SMEs. The EIB provided for 25% of the European risk-capital market, serving as a catalyst for overall investment of around € 3 billion in all Member States plus Accession Countries. Furthermore the EIB exerts a catalytic role in mobilising investments by commercial banks or the European Structural Funds. The EIB has played a particular role in taking forward both TENs and in supporting progress towards the Lisbon goals.

The EIB raised its capital 2002 from € 100 billion to € 150 billion. This increase is being financed from the EIB reserves, consequently avoiding recourse to Member States' budgetary resources. The EIB's capital is subscribed by the Member States in accordance with their economic weight. Only 6 % of the capital is paid in, the remaining 94 % act as guaranteed capital. As from 1 January 2003, the statutory ceiling on loans has risen to € 375 billion which should provide the Bank with headroom to cater for the growth in activity from its own resources over at least five years.

Analysing the only slight increase in the total volume of loans signed by the EIB of 39.6 billion in 2002, as against 36.8 billion in 2001, it seems apparent that not so much the EIB's capacity, but missing private investment activities and budgetary constraints connected with the SGP keep Member States from using to the full the potential role of the EIB as an engine for investment, and thus growth and employment. As at 31 December 2002, outstanding lending from own resources and guarantees amounted to € 234 billion.

For many years, support from the EIB has been identified as a key factor in ensuring the financial viability of longer-term investments, and particularly in providing the basis to mobilise private funding and structure public-private partnerships (PPPs). We would therefore stress the need to reinforce *its advisory and technical support to Member States and to the private sector, in particular to SMEs, in promoting development of PPPs both at policy and project level where appropriate as well as private investment, in order to ensure full use of its loan capacity for public and private investment activities.*

Furthermore, *in line with the Lisbon objectives, the EIB should invest further in projects which, because of their characteristics, especially the risk and clean technology involved*, cannot be funded by commercial banks and the capital markets. In this context we would welcome proposals for *specific instruments to meet the needs of SME investment projects and risk-capital projects that exceed the global loan ceiling of the EIB.*

4. Redirecting national public expenditure towards the Lisbon objectives

The sharp fall in public and private investment alike –2.3% in the euro zone and 2.4% in the European Union as a whole – has further weakened growth. One major issue is therefore to identify how to increase and define "high quality" expenditure in the interests of increasing investment activities in Europe. Public expenditure could be considered as 'high quality' if it makes a positive contribution to the goals of the Lisbon strategy, i.e. making the Union the most dynamic, competitive, knowledge based economy, enjoying full employment, strengthened economic and social cohesion and environmental sustainability.

EU budgetary surveillance was extended to the systematic assessment of the sustainability of public finances in the light of ageing populations, showing the potential risk for emerging budgetary imbalances in many Member States. However, public spending on the basic functions of the State (defence, justice, education, health care, R&D, clean technology, economic services) has remained remarkably stable over the past 30 years, and is very similar (between 14% and 16% of GDP) across Member States. Surveillance of the quality of public finances is still at an early stage. The difficulty in putting in place an effective monitoring of the quality of public spending is due to the conceptual difficulty in defining what 'quality' actually means, and the lack of timely and comparable data.

We therefore call for a clear method that includes a definition of 'high-quality public expenses' to quantify public budgetary positions and their contribution to growth and investment with a view to making a positive contribution to the Lisbon objectives, and we hope that the list of structural indicators will form an integral part of the budgetary surveillance framework and of national stability and convergence programmes. In this regard, and as a first step, t*he quality of public spending within the framework of the European Structural Funds should be more closely linked with all Lisbon objectives during the second phase of the programme period 2000-2006 and should be comparable in all Member States.*

5. Better co-ordination of high quality public spending between Member States

The institutional developments in economic policy-making reflect the recognition that a proper functioning of EMU requires a well developed coordination framework. This requirement is derived from the fact that although monetary policy is fully unified under the authority of the ECB, most other policy areas maintain separate national policy-making competences. Because policy preferences are defined in national constituencies, different governments have different preferences and objectives. But at the same time the growing interdependence between national economies within the same monetary framework has led to an increasing range of spillovers into other jurisdictions. What one Member State does, in particular in the field of public spending, increasingly affects all others and inconsistent policy objectives would lead to welfare lowering outcomes. The internalisation of these externalities creates the need for better policy coordination of high quality public spending. It means that an efficient policy mix is a necessary condition for the sustainability of macroeconomic stability. Therefore budgetary policy needs to be constrained.

To this end, national "growth programmes" should provide detailed information on the use of public spending as a contributor to sustainable economic growth, competitiveness, environmental sustainability and social cohesion. Special emphasis should be put on government investment expenditure in a wider sense (e.g. infrastructures, research, education and training), with particular attention to be paid to possible synergies among national and Community-wide public and private investment efforts, as well as on ways and means of stimulating a common investment policy. *To make such an exercise most effective, national budgets and "growth programmes" need to be issued at a common time during each year and contain comparable information between Member States.* Equally, those programmes should mirror political commitments made within the broad economic and employment guidelines, as well as policy objectives in the field of economic, environmental and social reforms (Lisbon and Göteborg Strategy).

Summarized and following the assessment and calculations of the economic effects (see annex), the promotion of investments in Europe will increase growth and employment considerably. According to the calculations in this paper the initiatives will increase growth by almost 1 percent per year in the period 2005-2007 and additional almost 0,5 percent per year up to 2010. The effect can be even larger if the initiatives increase confidence in the private sector in Europe.

Up to 2010 the initiative will create 3,4 million jobs and when the effects are fully absorbed in the labour market the effect can be up to 4,7 million jobs.

As the plan promote both public and private investment there will be no negative effect on the general government budget. Increased spending in the public sector is more than outweighed by increased public income from taxes and public savings from smaller expenditures on social benefits.