PERSPECTIVES FOR A COMMON STABILITY CULTURE IN EUROPE

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CONTENTS

5 | FOREWORD

7 | SUMMARY

13 | SOUND MONEY, SOUND FINANCES, A COMPETITIVE ECONOMY – PRINCIPLES OF A EUROPEAN CULTURE OF STABILITY
Peter Praet

23 | GERMANY – FROM THE “SICK MAN OF EUROPE” TO THE “NEW GERMAN MIRACLE”
Jürgen Matthes

31 | FRANCE’S CULTURE OF STABILITY
Rémi Lallement

67 | FISCAL STABILITY IN THE NETHERLANDS
Raymond Gradus | Hubert Beusmans

77 | SPAIN’S STABILITY PROGRAMME
Paloma Ferrero de Paz

97 | STABILITY CULTURE IN EUROPE REPUBLIC OF IRELAND – BOOM, BUST, RECOVERY
Dieter W. Benecke

113 | CULTURE OF STABILITY IN SWEDEN
Carl Johan Blydal

123 | CULTURE OF STABILITY IN THE EUROPEAN UNION
Stefan Gehrold | Joscha Ritz

130 | THE AUTHORS

131 | CONTACT AT THE KONRAD-ADENAUER-STIFTUNG

FOREWORD

The "euro crisis" has focused attention on the fact, that the eurozone countries are increasingly interdependent concerning macroeconomic developments like economic growth, employment or competitiveness. The crisis has served to emphasise how, more than ever before, it is important to ensure that every national economy can foster its perspectives of growth and wealth in a similar way. The ongoing process of European integration has led to European member states economies becoming more closely interwoven.

As a result, decisions or failure to take decisions on economic policy by individual countries no longer simply have an impact on their domestic economies but can also have a significant effect on growth and economic stability in every country in the eurozone. Today eurozone countries all share a common fate. They all benefit from a particular country's economic strength, but as well they are all affected by another country's economic weakness. For this reason, it is essential to intensify the debate on economic growth in the member states. This will promote a mutual understanding of each country's growth and open up a common European perspective that will help the member states to be more competitive and to maintain the stability of the single currency.

In our publication, we bring together perspectives of different member states with their experiences in reforming their economic and social systems. Our authors as well touch some historical and cultural backgrounds that characterise their countries' economies. If anything good is to come out

of Europe's sovereign debt crisis, then it is surely the fact that it has intensified the dialogue among European partners on economic policy issues, both successes and failures. Our publication shall contribute to that dialogue to identify chance and risk to develop European economic and financial frameworks in the sense of a stability union.

We hope to line out some fruitful insights about the common stability culture in Europe and hope that you enjoy reading.

Berlin, January 2013

Matthias Schäfer
Head of Team Economic Policy
Konrad-Adenauer-Stiftung

SUMMARY

Principles of a European culture of stability

Peter Praet – chief economist of the European Central Bank – reflected in his speech the emergence of principles of a European culture of stability during the crisis by referring to fundamental primacies of *Ordnungspolitik* that are: sound monetary policy, sound finances, solid institutions, as well as ensuring fair competition. Persistently stable price levels and moderate rates of inflation show that the European Central Bank meets its target and works effectively. Thus, deterioration on the financial market can not be traced back to a monetary crisis in its essence. Nevertheless, in the course of the financial crisis sound money is threatened and must be safeguarded by tackling the roots of the crisis. The fundamental cause of the current debt crisis is a lack of stability culture in Europe.

After an excessive debt built up in the last decades, economic governance in many societies dramatically failed to sustainably consolidate public finances when there was still time for it. Furthermore the architecture of euro area institutions revealed some gaps in effectively tackling debt crises thereby deteriorating the situation. Additionally some Euro economies did not achieve international competitiveness and thereby caused macroeconomic imbalances that were not sufficiently surveilled by the EU.

In summary, the pillars of *Ordnungspolitik*: sound finances, solid institutions and competition were not sufficiently considered and must be taken more seriously in order to establish a proper stability culture in Europe.

Germany

Whereas in the most European countries the economy is heavily suffering from the effects of the debt crisis Germany stands against this trend and experiences considerable growth in GDP and even more significantly in employment. In light of Germany's persistently stagnating economy a decade ago, the German economy has turned from the sick men into the economic miracle in Europe. The strong performance of Germany raises a great international interest in what measures have led to this remarkable

transition. The author deals with this question and gives an overview on several reforms that have been enacted during the last years and that might have contributed to Germany's economic success. German economic policy combines consolidation measures with reforms that strengthen the supply side and promote flexibility on labour markets. The latter reforms aim at a more effective use of capital and labour in order to enhance compatibility. The consolidation measures i.e. a reform of the pension system, an increase in VAT and an introduction of a debt brake focuses on a substantial growth that is not funded by debt and thus not be charged to future generations. With regard to the different political and economic circumstances the countries face, the author emphasises that there is no perfect bundle of concrete measures that can be adapted to all countries in the same way. Nevertheless, the author concludes that the lesson learnt from the German example is the importance of a strong political will for substantial structural reforms that address both competitiveness and consolidation.

France

By comparing the France's economic performance to Germany some similar developments but also significant differences come out that might give an indication for France's stability culture. In terms of price stability, France has steadily approached to the convergence criterion of Maastricht and just as Germany it is not heavily affected by volatility on the bond markets. Particularly the latter point – stability of bond price – is a great challenge many other Euro countries are currently facing. By this focus, France draws a similar image of stability as Germany does. However, with regard to budget stability there appear to be some differences between France and Germany. Prior to the economic crisis in Europe, France's public debt remained on a level significantly lower than the one of Germany. In course of the crisis, this relation has reversed and France has even overtaken Germany in public debt. France's high levels of public spending mainly consisting of security spending and labour costs might be one reason. Austerity measures introduced so far in France rather focus on increasing of tax revenue and do not address the structural debt that results from public spending. Therefore France should head to further austerity measures that effectively aim at public spending cuts.

Netherlands

In this article the author mainly deals with the different developments of Germany and Netherlands in course of the financial crisis. While in the beginning of the century the Dutch economic performance was comparable with the one in Germany, Netherlands was substantially hit by the crisis and faced a massive increase in debt. Even though the Dutch government also introduced measures to promote sound finances and economic growth it could not achieve such a relatively resistant economy as in Germany. The author sees the reasons for the diverging development in the structural reforms that have been enacted in Germany. In contrast, the Dutch economy has rather drawn its stimulus from high domestic consumption which just broke down in course of income losses. According to a poll indicating a major endorsement of sound finances in the public opinion, there appears to be a good basis for long term austerity measures and structural reforms for competitiveness.

Spain

Spain is greatly suffering from the effects of the financial crisis which has heavily distorted its economic performance. It can be hardly drawn some connections between current economic data and the general stability culture in Spain. Since in contrast to many other Euro countries, Spain's economic policy has early focused on budget consolidation and could thereby present a great reduction in governmental debt prior to the crisis. However, in the aftermath of the financial crisis Spain had to increase spending in order to prevent the Spanish banking system from collapsing and faced peaking interest rates for securities. Though Spain's public debt fell back to early levels it is still relatively low compared with most of the other countries in the Euro area. By constitutional reforms enacted through an agreement of the two largest parties in Spain in 2011 the objective of budget stability was constitutionally anchored and thus it applies a mechanism similar to the debt brake in Germany. Therefore Spain is less facing a problem on the expenditure side than rather the challenge of generating income. Due to a massive slump and subsequently a steadily stagnating economy Spain must focus on improving competitiveness in order to achieve economic recovery.

Ireland

The author gives an overview on the reasons for the remarkably bad impact from the financial crisis on the Irish economy by referring to the country's stability culture. Due to a period of an economic prosperity that was rather financed by debt than by sustainable growth the Irish economy was extremely vulnerable to the deterioration on the financial markets. Irish banks were threatened by collapse which is why the government decided to guarantee deposits and loans and even nationalise the Anglo-Irish Bank. These rescue operations were enacted by the government even though there were no reserves the state could have fallen back to. As consequence Ireland's public finances deteriorated and both national debt and deficit increased significantly.

Since 2010 Ireland seeks help from EU and has to fulfil the requirements by the EU-Troika. So far Ireland could manage to launch austerity measures and is still planning to continue this course. Apart from consolidation economic recovery and a reduction in unemployment are set at high priority. Ireland's prospective development will be dependent on measures by government. Building up a credible stability culture is crucial for Irish economy to attract foreign investments and thus to push on sustainable economic growth.

Latvia

Since its independence in course of the collapse of the Soviet Union Latvia is on a successful path directing to a membership in the eurozone. Following the transition process from a planned economy to a market economy Latvia became one of the fastest-growing national economies in Europe and thereby paved the way for its accession to the EU in 2004. Due to an ongoing economic upturn Latvia was enabled to fulfil the provisions as to fiscal stability demanded by the EU. Latvia remained below the maximum limits for budget deficit and public debt but it did not accumulate any reserves in these times of economic upswing. As a consequence of this pro cyclic economic policy Latvian economy was much more affected by the financial crises than its neighbour countries. After the collapse of one of the biggest national bank of Latvia, the government had to call for international funding by EU and IMF that went in line with strict requirements of austerity measures. By drastic cuts in public expenditures and tax increases, the government could quickly attain economic recovery and fiscal consolidation and thus received great international praise for this effort. But instead of introducing structural reforms, the initial austerity strategy was rather enacted at the expense of social policy which worsened the social situation in Latvia and led to declining public support for further austerity measures. It shows that austerity policy cannot sustainably apply when it does not go along with structural reforms wherefore the Latvian government currently pursues structural reforms that combats corruption and strengthens fair competition.

The stabilisation of monetary policy is an additional challenge regarding the traumatic experiences of hyper inflation in the past that have massively deteriorated the Latvians' confidence in the banking sector and in the central bank's role of lender of last resort.

Sweden

In this article the author emphasises a very positive development of public finances in Sweden which has become model for other European countries. Sweden's engagement in fostering sound finances has been starting already in the early nineties, when its economy was suffering from a world wide recession and facing weak public finances and currency. The newly resigned government for this time initiated a long-term consolidation process. Further ruling parties have adapted this course of sound finance so that there has been implemented an expenditure ceiling even in 1995. Since 2007 the government has been obliged to announce the spending restriction for the subsequent three years in the annual budget. Monetary policy has also changed in this period since the central bank became independent in 1999. From then the main task of the Swedish central bank has been maintaining price stability and safeguarding stability of financial affairs. Due to high commitments to trade unions the Swedish economy has faced overregulated labour market and rising wage costs. Political measures tackled this obstacle for competitiveness by reducing costs for employers and additionally introducing a higher tax threshold. Both consolidation measures and regulations in order to stimulate competitiveness were enacted early enough so that they could serve for a sustainable economic fundament. A majority of political spectrum in Sweden agrees on the importance of stability of public finances and prices and is thus in line with the EU fiscal pact, Germany has pushed through.

European Union

The economic situations among the Euro area are remarkably diverging between the single member states. Even though there might be traced a general pattern revealing that the northern European countries have a better economic performance the reasons for this cannot be generalised but have various backgrounds. In course of the crisis there have been launched reforms of the European architecture in order to promote convergence in competitiveness and fiscal consolidation. The first aspect is the introduction of a sanctioning mechanism aiming at an earlier detection and thus better handling of unsound fiscal policy. Second, the Euro countries agreed to the strategy Europe 2020 focussing on strengthening competitiveness. However, this strategy only succeeds when the guidelines are truly implemented on the national level. Thus the EU has no enforcing power and it remains to be seen whether the strategy can prove to be effective in practice.

The efforts in fostering fiscal stability and competitiveness are mainly initiated by the European People's Party which has a majority in the European parliament.

SOUND MONEY, SOUND FINANCES, A COMPETITIVE ECONOMY

PRINCIPLES OF A EUROPEAN CULTURE OF STABILITY[1]

Peter Praet

Ladies and gentlemen,

It is an honour for me to have been invited here today to speak about the emergence of a European culture of stability. In Germany, such a culture is the outcome of what is known as *Ordnungspolitik*. It involves the primacy of sound monetary policy, sound finances and solid institutions, as well as ensuring fair competition. *Ordnungspolitik* is firmly entrenched in German governance. Its intellectual roots can be traced all the way back to the Freiburg School of Economics and in particular Walter Eucken. It advocates an institutional framework promoting a free, yet ethically responsible, market economy. Within this framework, economic actors are then free to pursue their own goals.

Speaking at the Konrad-Adenauer-Stiftung today, let me also pay tribute to the first German Chancellor of the Federal Republic. He firmly believed in a new Germany, inside a peaceful and integrated Europe. He once said, "*Unser Ziel ist es, daß Europa einmal ein großes, gemeinsames Haus für die Europäer wird, ein Haus der Freiheit*" (Our goal is to turn Europe into a large house for Europeans to share, a house of freedom).

Today, I will provide you my reflections about how I see the crisis changing both Europe and Europeans. There are changes in governance, tighter rules, some new institutions have been created to complete the architecture of EMU, and some of the older institutions have tighter mandates and instruments. There is now realism and acceptance of the need for such changes as never before.

My reflections are organised along the subjects of sound money, sound finances and a competitive economy. Some lessons and final thoughts will conclude. Overall, I think there are signs of stabilisation that give us confidence about the future.

SOUND MONEY

The financial crisis we are experiencing is not a "monetary crisis" in its essence. The ECB has secured price stability. It is also remarkable that inflation expectations have remained anchored throughout the crisis. Looking ahead they remain anchored even in the distant future. Yet, the ECB has to continue earning the confidence it has acquired.

The operational framework of the Eurosystem, through which monetary policy is implemented, has proven to be resilient and effective. The ECB was the first central bank to respond to what was initially called "financial turmoil". A very important part of the ECB's policy responses came in the form of cutting rates and providing liquidity against collateral.

In order to prevent a serious credit-crunch – and preserve the proper transmission of monetary policy – the ECB embarked in a series of exceptional monetary measures. For example, last December the ECB decided to hold two very long-term refinancing operations with a maturity of 3 years against adequate collateral. The first was conducted already in December, and the second is forthcoming. These measures are supporting the liquidity planning of banks, thus allowing the flow of credit from banks to the real economy.

Hence, the ECB has delivered in line with its mandate. However, looking ahead we have to ensure that this will remain so. Risks that monetary policy may be overburdened in the future need to be counteracted.
The primacy of sound monetary policy and price stability must be safeguarded. It is our shared asset in the euro area.

In order to safeguard sound money, the other elements of *Ordnungspolitik* also need firming up. I now turn to them.

SOUND FINANCES

Sound finances entail two components. The first is sound public finances, while the second is provided by sound financial markets. The crisis has shown that fiscal stability and financial stability are linked. Unfortunately, both have struggled throughout this long, and mutating, financial crisis. Yet, there has been progress on both components.

A point sometime missed is that some of the root causes of the crisis go very far back in time. In many societies there was an excessive build-up of debt in recent decades: both sovereign debt and private sector debt (household & corporate). Warnings were voiced repeatedly, also by the ECB. But, the start of serious debt consolidation was continuously postponed, offloading on future generations. There was too much complacency, although many debt sustainability analyses showed that there was a limited period of time to truly address the problem. The crisis has cut the room for manoeuvre.

The economic downturn that followed the Lehman bankruptcy – which many refer to as the "Great Recession" – changed all this. It has brought the debt problem forward. The crisis and the recession have forced euro area countries to face their responsibilities right away. This entails undertaking very substantial adjustments now. Let me provide you with some reflections about the two main components of sound finances in more detail.

THE FISCAL COMPONENT OF SOUND FINANCES

Failings in national governance caused severe fiscal strains in quite a number of euro area countries, while, at the same time, European governance lacked teeth. The Stability and Growth Pact was even weakened in 2003 - at the behest of some of the largest euro area countries - and then reformed in 2005. This was not the only problem. Financial market discipline, another powerful deterrent, was virtually absent until well into the crisis, but came back with a vengeance over recent years. Financial markets became dysfunctional driving sovereign risk premia of a number of euro area countries ever higher. Hence, two important deterrents were missing in the first decade of EMU.

After the bankruptcy of Lehman Brothers, automatic fiscal stabilisers cushioned the impact of the crisis, and many European governments introduced economic stimuli programs. On top of this, the financial recapitalisation required was immense in some countries. As a consequence, deficits soared and governments' indebtedness surged.

The overall public sector deficit in the euro area increased from 1.4% of GDP in 2006 to 6.2% in 2010. At the same time, general government debt in the euro area rose from 68.5% in 2006 to around 85.6% in 2010. However, according to the European Commission's latest forecast, the deficit ratio should gradually decline to below 3% of GDP by 2013, while the aggregate debt ratio in that year is projected to exceed 90% of GDP.

This is a challenging legacy of the crisis. Today, a number of countries have embarked in fiscal consolidation programs, and as you know, Greece, Ireland and Portugal are now implementing ambitious adjustment programs. Hence, fiscal policies are adjusting as a response to the crisis.

But how can public finances be returned to soundness more fundamentally? How can sound fiscal institutions, and therefore sound fiscal governance, be secured in the future? The new fiscal compact – that is soon to be ratified – is a step in the right direction.[2] It addresses some of the weaknesses of the previous fiscal governance framework.

The fiscal compact has two main elements. The first is the mandatory introduction of a balanced budget rule and a correction mechanism for deviations from balanced budgets at the national level. The second element envisages a strengthening of the excessive deficit procedure within the Stability and Growth Pact.

If effectively implemented, the fiscal compact will help to anchor market expectations on the sustainability of public finances in Europe (and narrow the currently abnormal spreads). Yet, Governments now need to prove their commitment to these new fiscal rules by ensuring a rapid ratification of the new Treaty on Stability, Coordination and Governance in EMU, which includes the fiscal compact, its transposition into national law and by living up to the rules and the spirit of the fiscal compact.

THE FINANCIAL STABILITY COMPONENT OF SOUND FINANCES

August 2007 saw the start of the financial turmoil with an increasing loss of confidence in the financial markets, a drying-up of liquidity and an increase in both risk premia and counterparty risks. Ever larger volumes of so called AAA-rated privately issued assets became "toxic".

In September 2008, after Lehman's bankruptcy, money markets virtually seized up, financial losses rose rapidly and a process of deleveraging set in. Financial stress spilled over to the real economy with a sudden and very severe impact on trade and growth. This led to the global financial crisis.

How can financial markets be made sound again? This question raises many issues which I have not time to address here today but are fundamental, like:

- how can a better pricing of risk be insured?
- how can asset price bubbles be detected and corrected in time?
- how can procyclicality of financial markets be attenuated? and
- how can the financial system better align with the needs of the real economy?

There have been several institutional developments. A new supervisory framework has been put in place in the EU in order to share information and best practices, foster cooperation and identify sources of systemic financial risks at an early stage. It consists of two pillars. The first covers micro-prudential supervision and comprises the European Banking Authority as well as other supervisory agencies.[3] Supervisory colleges for pan-European banks are also starting to operate. The second pillar is dedicated to macro-prudential supervision and is centred on the European Systemic Risk Board. The ESRB can issue warnings and macro-prudential recommendations whenever necessary. In addition, the new Basel III rules are being implemented to secure adequate capitalisation of banks.

What explains the rapid contagion that has characterised the sovereign debt crisis? As I already said, the crisis has revealed weaknesses in the prevention side of economic governance. But, there were also other gaps

in the architecture of euro area institutions. This became apparent in early 2010 after the onset of the sovereign debt crisis in Greece. One after the other, fiscally weak euro area countries saw their sovereign risk premia rising and their rating downgraded. As a consequence, their sovereign spreads soared. An adverse feedback loop set in: a vicious circle by which weak sovereign hurt banks and the need for bank recapitalisation and refinancing hurt sovereign. Risk aversion by market participants soared: there was contagion.

The architecture of the Economic and Monetary Union (EMU) had been designed without a proper framework to manage a sovereign debt crisis (and which may have slowed down contagion).

One side of this institutional gap is now being addressed through the establishment of firewalls such as the European Financial Stability Facility (EFSF) - and the forthcoming European Stability Mechanism (ESM) – with their framework for sovereign crisis management and resolution.

Some further steps are still needed. For example, there are only national arrangements for interventions to resolve crises of big pan-European banks. Some account for a large share of national GDP of their home country. Thus, while progress was made on the sovereign side:

- we still lack a European crisis management and resolution framework for systemically important banks;
- there are as yet no funds earmarked or clear provisions to help in the recapitalisation of big banks (although the EFSF/ESM might acquire such a mandate as well); and
- the fundamental issue of institutions that are "too big to fail" has only started to be addressed.

Hence, it is fair to say that while a lot has already been achieved, some hard work remains ahead of us in order to secure fundamentally sound finances.

A COMPETITIVE ECONOMY

International competitiveness, i.e. a free, flexible, innovative and open economy, is the third pillar of *Ordnungspolitik*. Economic agents need to fulfil the highest global standards of efficiency. On this front, too, matters

in individual euro area countries have not, however, developed as would have been desired since the launch of the euro. There have been persistent economic imbalances in several euro area countries, and slow productivity growth in a number of others. The "Great Recession", the epicentre of which initially seemed to be far away, has exposed and exacerbated these weaknesses.

How could this go on for so long? Diverse national factors played a role: as a result competitiveness changed significantly and heterogeneities build up. Hence, there was also a lack of macro-economic surveillance and too little focus on job creation and improving growth prospects.

Many of these weaknesses are now being addressed by national policies. A number of euro area countries have started serious structural reforms. *But looking ahead, how can the euro area remain competitive more fundamentally?* A new Macroeconomic Imbalance Procedure (MIP) is now in place. A warning system is helping us in identifying risks arising from large and protracted swings in competitiveness as well as sustained budget deficits at an early stage. *How?* By monitoring amongst others, domestic prices, costs of production, wages, unit labour costs, export market shares, and productivity. The MIP complements the fiscal compact.

Hans-Gert Pöttering, the President of the Konrad-Adenauer-Stiftung and our host today, has put it very clearly: "*Die Durchsetzung umfassender Strukturreformen… kostet in erster Linie Kraft – nicht Geld"* (The implementation of comprehensive structural reforms … calls for great efforts, rather than money).

WHAT HAVE WE LEARNED FROM THE CRISIS?

The speed with which persistent imbalances in EMU can result in systemic risks was not fully understood prior to the crisis. An important lesson is that due to high trade and financial integration in the euro area, the build-up of imbalances in any individual euro area country increasingly affects all others. In other words, there are greater spillover effects on account of increasing interconnectedness. The financial contagion of the sovereign debt crisis is a case in point.

Therefore, substantial risks to fiscal and financial stability can build up if structural reforms, liberalisation and fiscal consolidation are postponed for too long, i.e. in the absence of an effective *Ordnungspolitik*. This leads to stress in our societies. For each euro area country, the pressures for maintaining sound finances and remaining competitive have grown tremendously. At the same time, also the incentives of each euro area country to monitor its peers have grown to virtually the same extent. Hence, my message is that each euro area country is a stakeholder in the success of the others.

SOME FINAL THOUGHTS

The global financial crisis has been a traumatic event in the still short history of the euro area. Yet, it has also been a wake-up call. In my view it has been a catalytic event that is changing both Europe and Europeans. The contours of a shared European culture of stability are gradually emerging. It is a culture of respect of rules and institutions and transparency. This will support the economic growth that is indispensable to heal the legacy of the crisis. But let us be modest and bear in mind that solutions to the crisis are only good:

- if they are thought through carefully,
- if they are widely accepted and shared by European citizens, and
- if they are widely implemented across euro area countries and, when needed, improved and strengthened as necessary.

As Konrad Adenauer put it many years ago, "*Die Einheit Europas war ein Traum Weniger. Sie wurde eine Hoffnung für viele. Sie ist heute eine Notwendigkeit für alle*" (The unification of Europe was the dream of a few. It became a hope for many. Today, it is indispensable for all).

1| Speech at the symposium on "Perspectives for a common stability culture in Europe" organised by Konrad-Adenauer-Stiftung, Berlin, 27 February 2012. I would like to thank Francesco Mongelli for his contributions to the preparation of this speech.

2| A "6-pack" came into force in December 2011, and a "2-pack" is soon to be finalised. They already envisage diverse strengthenings of the Stability and Growth Pact.

3| Two more supervisory agencies were also created: the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

GERMANY – FROM THE "SICK MAN OF EUROPE" TO THE "NEW GERMAN MIRACLE"

Jürgen Matthes

INTRODUCTION

Germany is currently displaying an astonishing economic performance compared with times of economic stagnation about a decade ago. Wide ranging economic reforms have significantly contributed to this success. The German – as well as other countries' experience – can potentially provide some useful lessons for the countries of the southern periphery of the eurozone which are currently in dire straits. This brief article provides an overview of the thrust and content of recent reforms in Germany and focuses particularly on fiscal consolidation and labour market reforms. Before this is done, an outline of the rather impressive economic performance is given.

1. INDICATORS OF SUCCESS

Several indicators of success can be listed. Generally, economic growth in Germany has recently been among the highest among industrialised countries, particularly within the eurozone and in comparison to the G7. This dynamism contributed to buoyant tax receipts and facilitated the consolidation effort of the German government. Consequently,

the general government deficit in Germany could be brought down to only one percent of GDP in 2011, after 4.3 percent in 2010.

More importantly, large gains on the labour market can be listed:

- The overall employment rate (15-64 years) has risen to 71 percent, the highest level since German re-unification (OECD data). The gain is even more impressive compared to the lowest level of 64 percent that pertained in the mid 1990s.
- The employment ratio of the low-skilled (employees below secondary education) has risen from 46 percent at the end of the 1990s to 55 percent. This is of particular importance because the low-skilled labour force has increased significantly – as a reflection of major failures of the German school education system to upgrade the skills of pupils from socially weaker or migrant backgrounds.
- Unemployment has declined from nearly five million in 2005 to slightly less than three million in 2011.
- Long term unemployment could be lowered from 1.7 million people in 2007 (when a new definition was introduced) to around 1.1 million.
- For the first time since the secular and continual rise since the 1970s the unemployment rate is now significantly lower than before the last recession. (Economists talk of reduced *hysteresis* in this respect.)
- Structural (non cyclical) unemployment has also been brought down (as measured by indicators like the so called NAIRU or the Beveridge curve).

2. SUPPLY SIDE REFORMS TO STRENGTHEN GROWTH DRIVERS

While some limited reforms were initiated already in the 1990s, the pace of reforms was significantly accelerated after 2003, when Germany entered a phase of economic crisis. In contrast to most other industrialised or emerging economies, economic growth in Germany did not pick up after the recession that had followed the burst of the dotcom bubble in 2000. Instead the German economy experienced a phase of near stagnation in 2002 to 2005. Moreover, unemployment rocketed to over

five million in early 2005 (even though this was also a result of a definitional change in classification). During this phase, Germany's economic growth rates were among the lowest among industrialised countries (together only with Italy and Japan) – and the term "sick man of Europe" was coined.

The main gist of reforms was to improve supply-side conditions and to strengthen important growth drivers, i.e. an increased use and efficiency of production factors (capital and labour) as well as technical progress.

- The use of capital can be increased by higher investment. This was fostered mainly by lowering corporate taxation and by bringing down bureaucracy costs.
- The use of labour – in terms of the employment rate – rose due to a wide range of labour market reforms which will be focused on later.
- Product market competition – and thus incentives to innovate and otherwise raise business efficiency – was increased by relaxing formerly stringent regulations, e.g. concerning many craft businesses.
- Productivity of the production factors was enhanced by corporate restructuring, including concentration on core competencies, outsourcing and offshoring.
- The ability to innovate benefitted from a significant increase in business financed R&D over the last decade – from 2.0 percent of GNI around 2000 to 2.3 percent of GNI in 2010.
- Following the disturbing revelation by the first PISA-study, that the (formerly renowned) German school system suffered from severe weaknesses, a wide range of education reforms have been implemented, e.g. harmonisation of exams on the level of the German Länder. In the meantime, PISA results have started to improve and thus also the quality of (young) labour.

3. FOCUS ON FISCAL CONSOLIDATION

In this brief reform review, a particular focus is laid also on the efforts to reduce government debts – motivated mainly by the intention to bring down the tax burden of future generations.

Before the financial crisis hit, the German government had achieved a small budget surplus in 2007, after having had produced budget deficits in excess of the Maastricht ceiling of three percent of GDP between 2001 and 2005. The impact of the financial crisis on government spending and revenues raised the deficit again.

Several factors contributed to the decline of the official deficit before the crisis hit. First, stronger economic and employment growth led to more buoyant tax revenues and lower expenditures for unemployment assistance and other social transfers.

However, also decisive policy actions played an important role.

- Government expenditure was cut from nearly 49 percent in 2003 to 43.5 percent of GDP in 2007 (now at around 46 percent in 2011 due to the crisis impact). For example, various subsidies were reduced and the social system was significantly overhauled.

- A wide ranging pension insurance reform introduced new rules to limit future pension increases by taking into account the rise in life expectancy and the ratio of employed people to pensioners. Moreover, in a further step the official pension age will be gradually extended to 67 years over longer term.

- The health insurance system was reformed in a less wide ranging and partly questionable way. Among positive changes, reforms shifted financing from wage related contributions to general taxes, further eased the social security contribution of employers, and limited the formerly large spending increases for pharmaceutical products.

- On top of expenditure cuts, also the (upper) VAT tax rate was increased by three percentage points from 16 to 19 percent – partly as a reaction to tax shortfalls which resulted from former tax reforms that had considerably lowered taxation of income and corporations. Thus, revenue collection was shifted from (more allocation distorting) income taxes to (less distorting) consumption taxes.

Moreover, Germany introduced a balanced budget rule after the financial crisis which is based on a cyclically adjusted measure for the public budget. If the budget deficit exceeds the allowed ceiling temporarily, a corrective mechanism has to eradicate the incurred government debts again in the following years.

4. FOCUS ON LABOUR MARKET REFORMS

In addition, a main focus of the reform agenda was laid on labour market reforms. The objective was to make labour cheaper and more flexible, to reduce entry barriers into the labour market, to provide greater incentives to work, and to improve job agencies.

Labour was made cheaper, i.e. the price of labour relative to the price of capital was lowered, in order to make hiring workers more profitable in relation to investing in machinery equipment.

- Due to co-operative trade unions, wages rose only moderately over an extended period.

- Working time was increased in many professions – to a limited extent, but without proportional wage increases.

- Non-wage labour costs were lowered by reducing social security contributions (mainly unemployment insurance) or by limiting (future) increases due to demographic changes, by reforming (as mentioned above) the pension and health care systems.

- Several reforms contributed to enlarging the low wage sector in Germany. So called mini jobs (with a total wage ceiling and no social security contributions) provide low-paid and part time employment mostly in the service sector. Moreover, incentives for the long-term unemployed were increased to take up lower paid jobs. Further opening up the low wage sector was a precondition for the (formerly mentioned) significant increase of the employment rate of the low skilled, as wages could be aligned more closely to the often rather low productivity of these employees. At the same time, low wage incomes were topped up by government transfers to reach the minimum social welfare level.

Labour cost were made more flexible by significantly broadening the scope for individual companies to opt out of sector wide wage agreements – in exchange for job security guarantees to their employees. Moreover, the flexibility of labour use was improved by further enlarging

working time flexibility, e.g. by introducing long term related working time accounts (which particularly played an important role during the massive economic downturn after the financial crises).

Lower entry barriers into the labour market make it easier for the unemployed to re-enter the labour market. This was accomplished by liberalising temporary work and fixed-term contracts. Moreover, job protection was lowered for firms between five and ten employees, as the difficulty to lay off permanent employees can constitute a disincentive for entrepreneurs to hire new workers in an increasing volatile business environment.

Additional reforms were packed into the renowned "Agenda 2010" which was announced in March 2003 by the coalition government of Gerhard Schröder. Under the headline of "Fördern and Fordern" (roughly translated as "Ask and Assist") the objective was to strengthen the principle of "flexicurity" (a combination of flexibility and security) in the labour market.

Asking more from the unemployed implied increasing the incentives and raising the pressure to take on a new job which could to larger extent than before be paid less than a former job. Failure to show sufficient efforts to apply for a new employment can now be more easily sanctioned by cutting unemployment assistance. Moreover, the generosity of the unemployment assistance system was considerably reduced by

- shortening the duration of first stage of unemployment assistance (which is related to former wage income) and
- by abolishing the former second stage of lower but permanent unemployment assistance which was also related to former incomes. The latter was achieved by introducing a means tested fixed unemployment assistance (Hartz IV) which is no longer related to former wage income, but to a social welfare minimum income level which depends, e.g., on family size.

Unemployed persons are now much better assisted in getting into new employment. More resources and an increased effectiveness of job centres contribute to this aim. Furthermore, the focus on active labour market policies has increased (e.g. re-qualification and training schemes, employment subsidies for hiring long term unemployed persons, public working schemes in the secondary private labour market).

5. WHAT CAN BE LEARNT FROM THE GERMAN EXAMPLE?

Germany's reform example is surely telling. Broad based reforms will achieve significant pay-offs in terms of economic performance and lower unemployment.

However, there is no reason to become paternalistic

- There are many earlier reform examples in other industrialised countries such as the United States, the United Kingdom and the Netherlands in the late 1970s or early 1980s or Denmark and Sweden around the turn of the following decade.
- In fact, Germany's labour market reforms reflect to a significant degree a benchmarking exercise. Particularly, the smaller northern continental European countries, which combine strong welfare systems with relatively well functioning labour markets, provided examples to learn from.
- Moreover, as all the other afore-mentioned countries, Germany also only embarked on a reform process after having run into a deep economic crisis. Learning was pathological in this respect.
- Germany has still several significant open topics on its to-do list, as e.g. the OECD continues to point out. Most pressing are better education and migration policies to mitigate the skill shortage in the labour market, further reforms of a in some respects still overburdening bureaucracy and further liberalisations in the service sector, for example with regard to still highly restricted professional services.

Bearing these qualifications in mind what can particularly southern European countries learn from the reform examples of Germany and other industrialised countries?

- Reforms should not be piecemeal, but broad based in order to create synergies and change formerly pessimistic expectations of economic agents.

- The pay-off of supply side reforms can take time to materialise and requires politicians with strong determination and perseverance. For example, the coalition government of Gerhard Schröder broke down under the burden of the reforms which were considered by many of their parties' voters to be socially unjust. However, recently the OECD pointed out that smart structural reforms can also provide significant short term benefits.

- It is important that following governments continue the reform process so that the change towards more positive expectation among entrepreneurs and consumers can persist. In fact, the governments under Angela Merkel have generally continued with reforms, albeit at a slower pace.

- It might become (politically) necessary to implement some minor corrections as the impact of the reform process is not known in all details beforehand and as some outcomes might be perceived as too socially problematic. While surely being debatable from a purely economic point of view, some measures fit this description in Germany, e.g. raising income taxes for the wealthy, the partly re-extension of the duration of the first stage of unemployment benefits for elderly people, or introducing minimum wages to counter excessively low wages (and potential very low wage competition from migrants from the eastern EU-countries).

- Finally, it is important to determinedly seize the window of reform opportunities because often only in times of crisis can strong vested interests which resist reforms be overcome for the benefit of the whole economy and society.

FRANCE'S CULTURE OF STABILITY[1]

Rémi Lallement[1]

INTRODUCTION

Since 2008, the European countries that have been most affected by successive phases of the economic and financial crisis are those that had previously adopted a growth model based on excessive levels of internal and external debt on the part of public authorities, private households and businesses. Within this context and with reference to the ongoing debate in Germany, the "culture of stability" can be defined as a consensus around the idea that a country's economic growth can only be guaranteed in the long-term by maintaining sound public finances, relatively stable price levels and sufficiently competitive manufacturing conditions (particularly with respect to labour costs) in order to avoid the creation of external debt.[2] Going beyond this very general definition, the idea of stability is not always viewed in the same way by France, Germany and other EU countries. This fundamental question is not only about the stability but also about the *sustainability* of the systems for growth in the respective countries, which leads on to an analysis of their capacity to implement the structural reforms necessary to create lasting competitiveness.[3]

In order to evaluate the extent of this "culture of stability" in France, it is useful to refer to a series of criteria covering various aspects. From this perspective, we shall be consider-

ing the following: an international comparison of global trends for certain general indicators of "sound management" (section 1); budgetary and fiscal policy in France in structural and institutional terms (section 2); monetary policy and particularly the role entrusted to the central bank (section 3); the part played by the "culture of stability" within the political parties and amongst social partners and the rest of civil society (section 4); the role of this culture in public opinion, with particular reference to survey results (section 5); and finally the structural reforms undertaken to increase competitiveness via certain channels such as reforms to the tax system, wage policies, the labour market, etc. (section 6).

1. SOME GENERAL INDICATORS OF "SOUND MANAGEMENT" – AN INTERNATIONAL COMPARISON

The general indicators of "sound management" mainly lead to the consideration of common convergence criteria such as indicators relating to private debt.

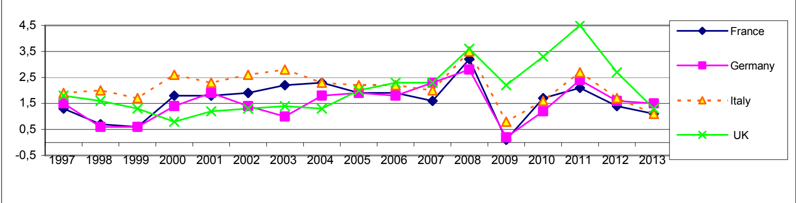
The rate of inflation: France converts to price stability after a quarter of a century

With reference to the Stability and Growth Pact, first of all it is necessary to look at the convergence criteria known as the "Maastricht criteria". France has demonstrated its stability with regard to many of these criteria since the 1990s. Over the last 15 years, France's rate of inflation has been close to that experienced by the other "major" countries of Europe such as Germany, Italy and the United Kingdom. According to the OECD, the rate in 2011 was lower than in Germany and it will remain so in 2012 and 2013.

Long-term interest rates: a relatively small range compared to Germany

Another of the Maastricht convergence criteria relates to long-term interest rates. In France, these have remained relatively close to rates in Germany. It is true that, compared to Germany, the gap in interest rates for 10-year government bonds averaged 125 base points in the 4th quarter of 2011, but the corresponding gap was much stronger compared to countries such as Italy or Spain (at 468 and 372 base points

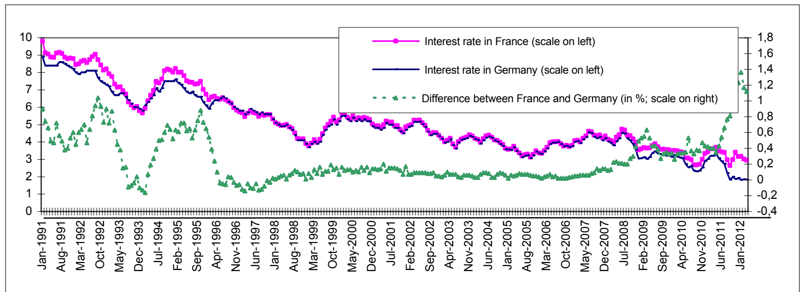
Fig. 1: Rate of inflation: increase in the Consumer Price Index (in %)



Source: author's own chart based on OECD figures (*OECD Economic Outlook*, various editions).

respectively). To be more precise, the gap between France and Germany had undeniably grown in 2011, increasing from an average of 43 base points in May to 154 in November 2011 (Fig. 2). However, this differential returned to an average of 112 base points in March 2012, a level that was close to that of September 1992. It should also be remembered that over the last twenty years the differential has at times been in France's favour, particularly during certain months of 1993, 1994 and 1996 and throughout most of 1997.

Fig. 2: Long-term interest rate from January 1991 to March 2012 (in %)



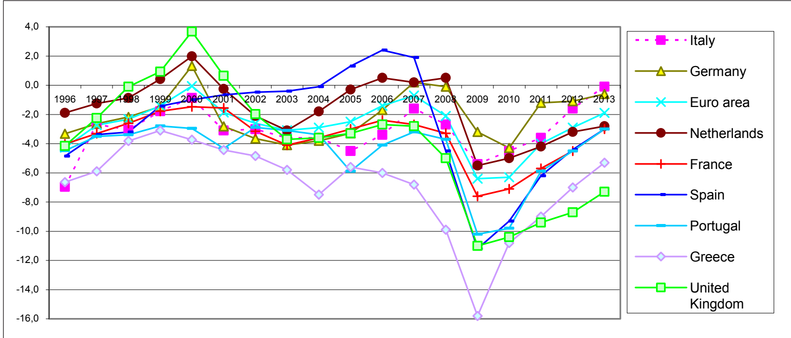
Source: author's own chart based on OECD figures.

The public deficit: net deterioration over forty years

Although the management of public finances has always been relatively strictly regulated in France, over the last decades, and particularly since the oil crisis, the situation has deteriorated significantly. The last surplus in French public finances goes back to 1974, when it represented 0.4% of gross domestic product (GDP). Since then, the balance has shown a

loss on all counts. This deficit peaked at over 7% of GDP in 2009 and 2010, under the double impact of automatic stabilisers and discretionary measures taken to boost the economy in December 2008. In 2011 it was at 5.2% of GDP, a figure that was well above the average in most other eurozone countries (3.7% of GDP in 2011, according to provisional estimates by the European Commission). It has also exceeded the deficit level that would allow a reduction in the debt/GDP ratio, with the current deficit running at around 2.5% of GDP, according to the latest report by the Court of Auditors[4]. In any case, the terms of its stability programme mean that the government is committed to reducing the deficit to 4.4% of GDP in 2012, then to 3% in 2013[5].

Fig. 3: Fiscal balance for all public administration (in % of GDP)



Source: author's own chart based on OECD figures (*OECD Economic Outlook,* various editions).

The necessity for this budgetary consolidation is also illustrated by other indicators: the structural deficit, the interest burden, the cost of government borrowing and the public debt itself.

In France, the *structural* public deficit, (i.e. the deficit regardless of economic fluctuations) in 2010 was assessed by the OECD to be 4.6% of GDP in 2010, while the Court of Auditors estimated it to be 5%. In any event, it is much higher than the European average. This structural deficit already stood at 3.7% of GDP in 2007, just before the effects of the financial crisis hit Europe[6]. France's *primary* structural deficit (i.e. before interest payments) was 2.1% of GDP in 2011, according to the provisional figures published by the European Commission. If the primary structural deficit were to remain at this level, then debt would be 100%

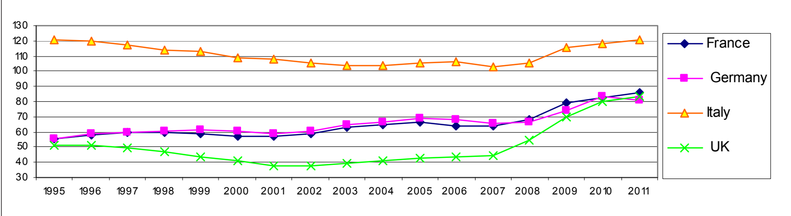
of GDP in 2015 or 2016, then 122% or 113% of GDP in 2020, depending on the assumption used relating to potential growth rates and interest rates[7].

The fact is that the public debt burden (interest totals) is expected to rise to 48.8 billion euros in 2012, or 15.5% of the national budget[8]. The corresponding figure was around 10% in the mid-1990s and 3% in 1978[9].

In 2011, a year when public spending amounted to 55.9% of GDP, according to the results published by INSEE in March 2012 the public deficit reached 5.2% of GDP. Consequently, almost 10% of public spending was financed by borrowing, the equivalent of more than one month's expenditure.[10]

The public debt-to-GDP ratio fell steadily between the late 1950s and 1980, but since then it has grown incessantly, passing the 18.5% mark in 1980, hitting around 60% in 1998 and then surging to over 70% between 2008 and 2009. According to the OECD's latest report on France, this accumulation of debt is due to the fact that fiscal policies are contra-cyclical during economic downturns but cyclically neutral or even pro-cyclical during upswings.[11] In any case, once France's public debt approached 86% of GDP in 2011 the Court of Auditors predicted that it would come close to 88% of GDP in 2912, compared to 81% in Germany.[12] This development marks a major change, because the French ratio has remained significantly *below* that of Germany for most of the last decade (fig. 4).

Fig. 4: Public debt-to-GDP ratio (in the Maastricht sense) (in %)



Source: author's own chart, based on Eurostat data (February 2012).

A difficult situation: economic slowdown in France

Restoring order to public finances risks being made more difficult by lower growth forecasts, in a situation where the financial crisis of 2009-2009 followed by the eurozone crisis have had lasting repercussions on domestic demand, particularly corporate investment and household consumption, mainly as a result of the rise in underemployment. As a result, the main growth drivers are in danger of remaining seized up for many years to come.[13]

Table 1: The public deficit, debt and GDP growth in France (2010-2014) according to government forecasts (in % of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014
Balance of public expenditure	-7.1	-5.7[a]	-4.5[c]	-3	-2
(State + ODAC)	-5.8	-4.8	-3.8	-2.7	-2.1
(Social security bodies)	-1.2	-0.8	-0.5	-0.1	0.2
(Local authorities)	-0.1	-0.1	-0.2	-0.2	-0.1
Public debt	82.3	84.9	88.3	88.2	87.1
GDP growth rate (volume)	1.5	1.75[b]	1[d]	2[e]	2

ODAC stands for over 700 different state-run statutory bodies that generally have a non-commercial function.
Source: Court of Auditors, *Le rapport public annuel – Tome I: Les observations*, February 2012, in accordance with the first finance law (for 2012) and the speech given by the prime minister on 7 November 2011.
[a]: -5.2%, according to the results published by INSEE in March 2012; [b]: 1.7 %, according to the results published by INSEE in March 2012; [c]: 4.4% according to forecasts by the Ministry of the Economy and Finance (MINEFI), revised end March 2012; [d]: 0.7% according to the MINEFI forecasts (March 2012); [e]: 1.75% according to the MINEFI forecasts (March 2012).

The ratings agencies: slight downgrading since autumn 2011

In light of this difficult situation and despite the measures announced or already introduced by the government, some of the ratings agencies have given France a slight downgrade. First of all, in January 2012 Standard and Poor's downgraded France (and 8 other eurozone countries) from AAA to AA+. It largely blamed this decision on the eurozone crisis[14], expressing its worries about the weak capacity for growth of the countries concerned. Then in mid-February Moody's decided to change France's economic outlook to negative (and also that of 8 other EU countries, including the UK), raising the likelihood that a similar downgrade is on the horizon. Moody's attributed this status change to "the ongoing deterioration in France's public debt". As far as these agencies are concerned, these adjustments may slightly reduce the country's financing conditions but it is likely that this has been anticipated by the markets since the autumn of 2011.

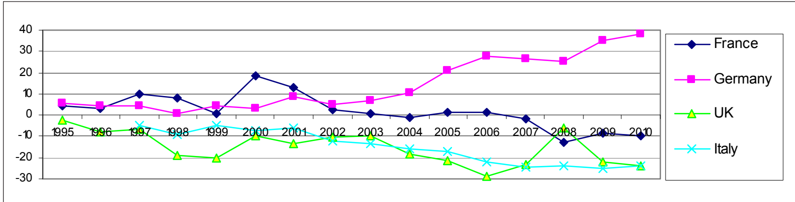
Although the government measures that have been announced or already introduced have not succeeded in avoiding at least a partial downgrade on the part of the ratings agencies since autumn 2011, it seems they have at least served to convince the financial markets[15], judging by the trends observed in the bonds markets up until March 2012 (cf. fig. 2, below).

High amounts of public debt held by non-resident investors

The total amount of public debt (other than national debt alone) held by non-resident investors is higher in France (at 57% at the end of 2009) than the eurozone average (52%), and much higher than in Germany (50%), Spain (46%) and Italy (43%); from 2004 to 2009 this rate increased particularly steeply in France.[16] This relatively strong dependence on foreign investors should, however, not be simply considered as a weakness or as a risk factor, as it also points to the fact that French public debt is valued by foreign investors.

As is underlined by the latest annual report from the Court of Auditors, what really matters in terms of reassuring the markets is the capacity to rebalance the current account, which involves the external global debt of public *and private* bodies.[17] Since 2007, France's current account balance has recorded a deficit, which has led its net external position to slip back slightly into negative territory (fig. 5).

Fig. 5: Comparison of net external positions (in percentage of GDP)

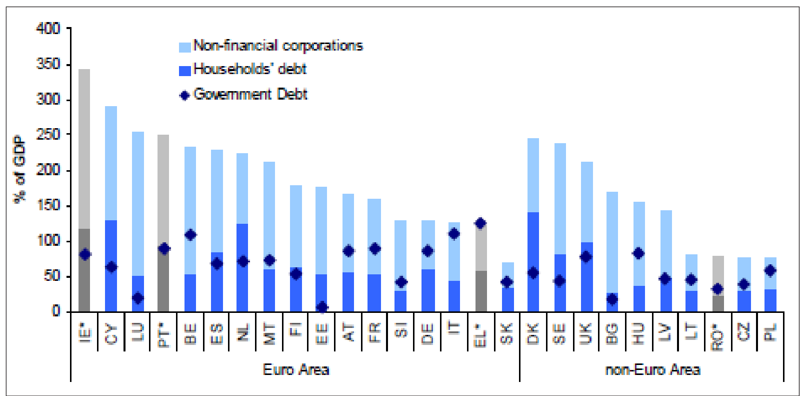


The net external position is a country's net financial position (difference between assets and liabilities) compared to the rest of the world.
Source: author's own chart based on Eurostat data (February 2012).

France's private debt: in future a little higher than in Germany

In light of the fact that the economic and financial crisis in many European countries (such as Spain, Ireland and the UK) has its roots in a banking crisis caused by excessive levels of *private* sector debt, this last element constitutes a possible cause of financial instability. As a percentage of GDP, French private debt (households and corporations) will in future exceed that of Germany, despite the fact that the opposite was the case before 2007.[18] Although the level of corporate debt is higher in France than in Germany, household debt is slightly lower (fig. 6).

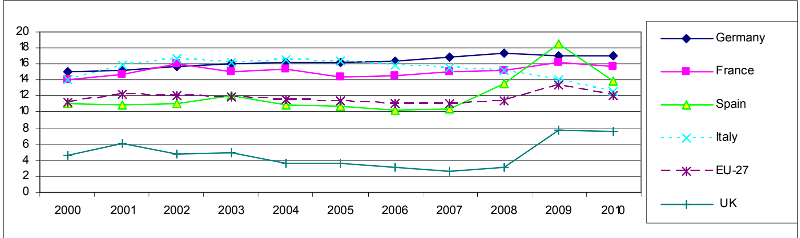
Fig. 6: Levels of debt by type of debt holder, in % of GDP (2010)



Countries that have received a bailout are shown in grey and marked with an asterisk. For private debt, the figures are based on non-consolidated data.
Source: European Commission, Alert Mechanism Report – Report prepared in accordance with Articles 3 and 4 of the Regulation on the prevention and correction of macro-economic imbalances, Brussels, COM(2012) 68 final, 14.2.2012, p. 12.

It is true that the household saving rate in France has increased sharply since its low point in 1987 (11.1% of gross disposable income), in 2011 hitting a level (16.8%) that it had not seen for 30 years. Within the EU, only Germany, Belgium and Slovenia have a higher rate, according to Eurostat statistics.

Fig. 7: Household saving rate (in % of gross disposable income)



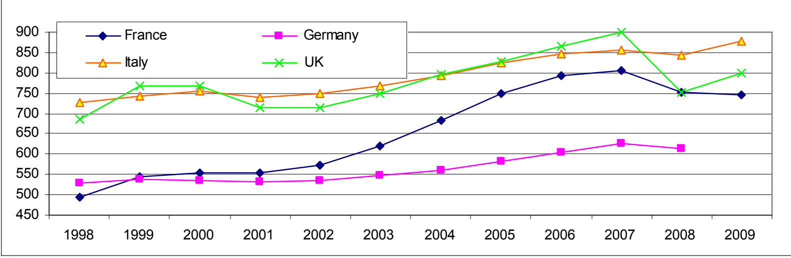
Source: author's own chart based on Eurostat data.

Household net worth: proportionately higher in France than in Germany

As far as private debt holders are concerned, the debts should be compared with accumulated assets, leading to consideration in terms of net assets (or net worth). This net worth as a percentage of a household's nominal disposable income is lower in France than in the UK and Italy but higher than in Germany (fig. 8). In France, this household net worth grew strongly in 2010 (+ 9.1 % in value), a year when it corresponded to 8 years of household net disposable income, returning close to the 2007 level after two years of contraction caused by the economic and financial crisis.[19]

These differences are undoubtedly largely due to differences in the property markets of the various countries. The property market in France is characterised by very high prices (on average higher than in Germany), whereas prices have dropped sharply since the financial crisis in countries such as the UK. This is probably the reason why France, a country that is home to only 1.1% of the world's adult population, came fourth in 2011 in the global rankings of individual adult net worth, behind China and just ahead of Germany, according to a Credit Suisse report that rates the situation in France as being robust and resilient in this respect.[20]

Fig. 8: Household net worth (as a percentage of nominal disposable income)



The figures represent nominal values observed at year end. The household sector includes non-profit organisations providing services to households, except for Italy. The net worth corresponds to financial and non-financial assets minus liabilities. Non-financial assets principally include housing and land.
Source: author's own chart based on OECD data (*OECD Economic Outlook*, n° 89, May 2011).

2. BUDGETARY AND FISCAL POLICY: STRUCTURAL AND INSTITUTIONAL ELEMENTS

Apart from these global aspects, it is necessary to clarify the diagnosis concerning structural and institutional elements, particularly with respect to budgetary and fiscal consolidation.

The question of the fiscal "Golden Rule"

At the beginning of 2012 there was only one constitutional reform bill designed to balance the public finances. This was adopted on 13 July 2011 by the two parliamentary chambers but has not yet been ratified because of the change to the Senate majority after the elections of 1 October 2011. The socialist opposition has taken over the majority in the Senate and does not support this "Golden Rule", at least not in its present form. This bill makes it compulsory to adopt framework laws for the balancing of public finances by means of programmes aimed at achieving this balance and by making the finance laws that are adopted by parliament each year binding. As part of this, ceilings for receipts and expenses will be fixed each year and be binding on the national budget and social security budget.

At present there is no French equivalent of the "debt brake", the constitutional mechanism created in Germany in early 2009 that came into force in 2011. However, a similar mechanism is to be introduced in France, as it forms part of the new European treaty emanating from the agreement of 9 December 2011 and signed by 25 countries on 2 March 2012. At the beginning of 2012, the executive was planning to organise a referendum in order to circumvent the problem of the Senate.[21]

French economists are fundamentally divided on this issue. Some are generally hostile to the principle of budgetary rules, saying that the proposed rules are not economically satisfactory in as much as they do not provide an optimum policy for stabilising the economy when faced with crises such as that currently raging in the eurozone.[22] Other economists take a more positive view, feeling that the fiscal "Golden Rule" is a step in the right direction but adding that this rule should not dispense with the need to take a vigilant attitude towards the structural dimension of budgetary and fiscal policy, particularly as far as the content (quality) of public spending is concerned – and above all in relation to investment expenditure – and towards how consolidation measures are split between lowering expenditure and increasing taxation.[23]

Budgetary consolidation: finding the right combination of making spending cuts and generating additional revenue

However, according to the Court of Auditors, the two austerity programmes introduced in France in 2011 have mainly led to tax increases rather than spending reductions. This body estimates that in future it would be more appropriate to avoid tax increases and instead to reduce tax exemptions (tax loopholes) – by more than 15 billion euros compared to 2010 – and to reduce social security loopholes by 10 billion euros.[24]
In response to criticism from the Court of Auditors, the government in power in February 2012 declared that the recovery measures necessary for the period 2011-2016 had already been adopted, with the focus on a two-tier reduction of expenditure (see table 2, below). According to the government, the steps that have already been taken or announced correspond to a total of 115 billion euros, of which 74 billion represents spending cuts and 41 billion represents additional revenue.[25]

Table 2: Budgetary and fiscal impact of measures implemented or announced for the period 2011-2016: selected examples (in billion of euros)

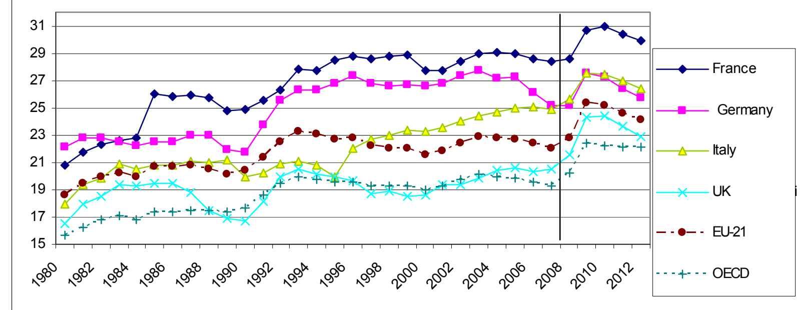
Spending cuts	**74**	**Additional revenue**	**41**
Functions and actions of the state and its agents	27	Budget measures 2010	12.4
Health insurance	19	**Freezing (non-indexation) of income and corporate tax scales, etc.**	3.4
Pension reform	16	Abolition or reduction of tax loopholes, particularly in property sector ("Scellier" law, zero interest loan)	2.6
Total public sector wage bill	9	Reduced VAT rate increased from 5.5 % to 7 %	2.09
Local authorities	2	Abolition of capital gains allowance on property	2.02
Family and housing benefits: sub-indexation in 2012	0.4	**Restriction on carrying forward of losses (corporation tax)**	1.74
		Increase in social security contributions on capital income (+1.2%)	1.54

Principal source: article published in *Les Echos* (8 February 2012), based on data supplied by the Budget Ministry.

A major challenge: limiting the increase in social security spending

When it comes to cutting public spending, the main focus should be on reducing social security expenditure. In France, this expenditure represents 46% of total public spending, and the amount spent in relation to GDP is higher than that of most comparable countries (fig. 9). As this expenditure is growing faster than revenue, the social security accounts are showing a structural deficit. The increase in social security spending is thus contributing to French public debt.[26] As has been stressed by the Court of Auditors, the challenge involves setting in motion structural reforms to achieve a lasting reduction in the rate of increase in social security expenditure, without compromising the quality of the welfare system. Health insurance is particularly important in this respect[27].

Fig. 9: Social security expenditure in selected OECD countries (in % of GDP, from 1980 to 2012)

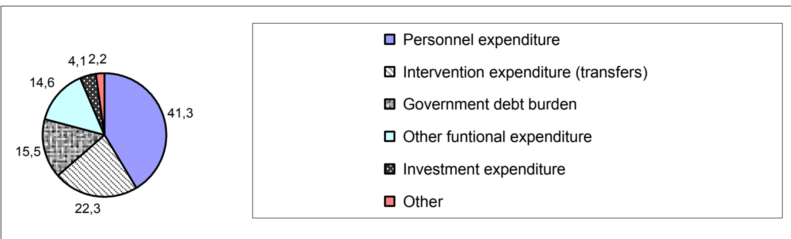


Calculations based on detailed data for the years 1980-2007; forecasts for the period 2008-2012.
Source: author's own chart based on OECD data (OECD Social Expenditure Database: SOCX).

Other major challenges for controlling spending: the government and local authorities

In terms of budgetary policy, the other challenges relate to the government and local authorities, which represented respectively 32.25% and 21.5% of French public spending in 2009. The process called the *révision générale des politiques publiques* (RGPP) (general review of public policies) which was launched in 2007 focused mainly on reducing or limiting labour costs (non-replacement of 1-in-2 workers taking retirement) and other operational expenses incurred by government and various central administrative bodies. However, out of around 80 reduction and rationalisation measures, a little over 40% of savings permitted by the RGPP have been in the area of operational expenditure (transfers to households, businesses, local authorities and associations). The OECD believes there is still considerable scope for reducing these operational expenses and that, going beyond the RGPP, it will also be necessary to reform the organisation and governance of public authorities at local level in light of the fact that France has so many layers of local government and a huge number of administrative districts.[28]

Fig. 10: Structure of national budget by major function (2012; as a % of the total)



Source: Ministry of the Economy, Finances and Industry, *Le budget de l'État voté pour 2012 en quelques chiffres (Loi de finances initiale)*, February 2012.

It is all the more important to gain control of public spending in view of the fact that France's high level of public spending compared to GDP – a ratio of 56.6% in 2010 – has left it in third place among OECD countries, after Ireland and Denmark. France is different from the other countries in this respect because of its very high levels of welfare spending.[29]

Compulsory deductions: once again an increase compared to GDP since 2009

This particularly French characteristic can be seen in the area of government revenues. In fact the rate of compulsory deductions in France has climbed steeply over the last forty years, from around 34% of GDP in 1974 to around 42% in the mid-1980s. After reaching a peak of 44.9% in 1999, it then fell to around 42% in 2009[30]. However, it has increased again as a result of the effects of the recent crises. From 43.8% in 2011, it is likely to exceed 44.8% in 2012 and is forecast to reach a level of 45.3% in 2013, breaking the previous record set in 1999.[31]

A complex and fast-changing tax and regulatory system

In France, going beyond the question of the level of compulsory deductions, there is the persistent problem of the relative complexity and changeability of the tax system. The Court of Auditors has listed over 500 tax loopholes and 1,337 mechanisms for the intervention of the government in the economy.[32] It is of course true that the German tax system can be considered at least equally complex.[33] On the question of instability, a recent example has been provided by the "fiscal compact" launched in 2007.[34] In any case, this double problem of complexity and instability also has a wider impact on the legislative and regulatory framework. For years, the Council of State has been bemoaning the tendency towards legislative inflation and calls this phenomenon an element of "legal insecurity".[35]

State aid and industrial policy: increasingly cautious policies

With respect to state aid for specific sectors, the data provided by Eurostat allows two observations to be made. As a percentage of GDP, the level of state aid granted in France in the last decade was very close to the average level for the EU-27 and *below* that of Germany; however since then this has been turned on its head: between 2008 and 2010, France overtook Germany and the UE-27 average and is now just above Italy and the UK.[36]

That being said, there have recently been more reassuring developments in the area of public subsidies and industrial policy. Firstly, this particularly applies to the question of tax loopholes. The Court of Auditors believes that many of these tax exemptions have little effect on the economy[37] and the current government has recently announced that some of them will be reviewed and has already replaced or closed others. Secondly, French industrial policy has become more compatible with competition policy, particularly since the middle of the last decade. In the past it consisted mainly of discreetly supporting large companies ("national champions") within given sectors, but now it is mainly focused on putting in place favourable "ecosystems" to promote innovation, particularly for SMEs, and using more local mechanisms (such as the "competitive clusters" that were approved in 2004), and generally by means of governance revolving around competitive mechanisms including calls for submissions (such as the "future investments" launched in 2009).[38]

Informal economy, tax fraud, corruption: relative stability in the rankings

A phenomenon that is often linked in importance to the complexity of the tax system is the informal economy (undeclared work). In 2012, this represented 10.8% of GDP in France, slightly more than the UK (10.1%) but less than Germany (13.4%), Italy (21.6%) and the average in the

21 OECD countries under consideration (13.3%)[39]. Equally, according to official estimates, tax fraud in France in 2008 reached an annual total of 25 to 30 billion euros, compared to approximately 30 billion euros in Germany and 100 billion dollars in the USA.[40]

With regard to the corruption perceptions index published by Transparency International (TI), in 2011 France was ranked 25th out of 183 countries with a score of 7.0 (Germany came 14th with 8.0). The earliest available results for 1998 show that France was 21st out of 85 countries with a score of 6.7 (Germany: 15th at 7.9). So since that time, the trend in France has been similar to that of Germany, with a slight improvement in its score and only slipping back in the rankings because of the larger number of countries now included in the study. This overall impression is corroborated by the French branch of Transparency International (TI), which rates France's progress in terms of fighting corruption over the last five years as lacklustre characterised by a mixture of advances and setbacks.[41]

3. MONETARY POLICY: HOW MUCH INDEPENDENCE SHOULD THE CENTRAL BANK HAVE, AND WHAT IS ITS ROLE?

Alongside budgetary and fiscal policy, monetary policy is clearly the third main area where governments can take action to promote economic stability. The main question in this respect is the central bank's degree of independence and its attitude towards monetary stability, along with its possible role as lender of last resort in situations such as the current crisis in the eurozone.

Since the 1980s, France has been largely converted to monetary stability

For many years, France suffered under a relatively high rate of inflation and resorted to devaluing its currency in order to restore the global competitiveness of its manufacturing sector. However, up until the early 1980s, these successive devaluations of the French franc only provided temporary relief for the country's balance of payments accounts and only served to fuel inflation. However, the situation changed markedly after 1983, when a policy of "competitive disinflation" was adopted aimed at making lasting improvements to the competitiveness of French industry. Also known as the "strong franc policy", this direction was followed for

20 years by successive governments on both left and right of the political spectrum. Jean-Claude Trichet was one of the symbols of this policy. Before taking over as governor of the Banque de France (from 1993 to 2003), and then becoming President of the ECB (2003-2011), he had been head of the Treasury (1987-1993), holding a position at the heart of the French Ministry of Economy, Finances and Industry which plays a major role in setting the general direction of France's economic policy. As President of the ECB, Jean-Claude Trichet was generally considered to be a champion of a strict monetary policy of stability, even though there is a great deal of debate in both France and Germany about the pertinence of the steps taken by the ECB since May 2010 in the face of the eurozone crisis.

The *Banque de France* has operated independently of the government since 1 January 1994 (pursuant to a law passed on 4 August 1993). Its role in defining monetary policy in France has been assured by the European Central Bank since 1 June 1998. Its main responsibilities are monetary stability, financial stability and the provision of services. In France, the idea that the central bank – currently the ECB – is not designed to finance public debt is being hotly debated in the public arena and particularly in business spheres, although less consensus has been reached on this than in Germany.[42] Many experts agree that it makes no sense to talk of budgetary discipline if at the same time the central bank is systematically buying up government debt.[43]

Should it act as lender of last resort during times of extreme crisis?

However, the "unconventional" policies pursued over recent times by the ECB have generally found favour in France in light of the particular problems caused by the eurozone crisis. Firstly, this applies to the programme of buying government bonds that has been followed since May 2010 with regard to the national debt of Greece, Portugal and Ireland, and then in August 2011, Spain and Italy. This instrument may be used once again in light of the current problems faced by these two latter countries, according to Benoît Coeuré, Deputy Director General of the French Treasury and chief economist at the Ministry of the Economy in Paris, before joining the board of the European Central Bank at the beginning of 2012.[44] As this instrument has been the target of strong criticism from countries such as Germany and the Netherlands, who reject the idea that the ECB should be a lender of last resort *for countries*, the bank has played this

role *for banks* in the eurozone, first of all in December 2011 then in February 2012, by providing these financial institutions with large sums for refinancing by means of three-year loans at low interest rates on the interbank market. Most economists[45] and policymakers in France are satisfied that the ECB is therefore now playing a greater role than was the case in the last decade, proving that it is sufficiently flexible during the exceptional circumstances caused by the current crisis. Many French economists – like some of their colleagues from Germany[46] and from the Bank for International Settlements[47] – have shown in this way that they understand the recent policies pursued by the ECB. They point out that the ECB's strategy is aimed at maintaining price stability (the principal objective) not only via a *monetary strategy* (the idea of a "first pillar" via steering monetary and credit aggregates), but also taking into account other elements (the "second pillar") that focuses more strongly on *economic and financial stability*, even if in this respect the idea of macroprudential policy remains difficult to precisely define.[48] In any case, many French experts insist that it is necessary to *use an instrument that is capable of stabilising the bond markets*, saying that the new role played by the ECB in this regard since December 2011 should only be temporary, for as long as the European Stability Mechanism (ESM) is not in a position to do this.[49]

In a similar vein, and despite the fact that Berlin is hostile to the idea, Paris (and Rome) have recently argued that the European Financial Stability Facility (EFSF) should be granted a banking licence so that it can gain access to the ECB's reserves and increase these resources to create a kind of European firewall.[50] This idea is similar to that proposed by Christopher Sims, current President of the American Economic Association and winner of the Nobel Prize in Economics in 2011: act to ensure that government debts are shared out, link budget discipline to the European Central Bank (ECB) and thus allow the latter to act as lender of last resort[51], a role that is played by the central banks in the USA, the UK and Japan.

4. WHAT ROLE PLAYS THIS "CULTURE OF STABILITY" IN THE POLITICAL PARTIES, AMONG THE SOCIAL PARTNERS AND THE REST OF CIVIL SOCIETY?

Going beyond the decision-makers within public administration, what is the role of the "culture of stability" in the programmes of the political parties, in the principal ideas of the social partners and in the rest of civil society, including on the part of academic experts?

The political parties and experts who are more or less in tune with the "culture of stability"

The UMP (*Union pour un Mouvement Populaire*), the majority ruling party from 2007-2012, has been increasingly tending to support the German-style culture of stability and, in a broader sense, the "German model", particularly since 2010. One of the reasons for this is that there is still relatively strong resistance to austerity measures in France.[52] However, for many years the other parties have focused on the urgent need to put the public finances in order. Since the 2007 presidential campaign, the candidate from the centre-right *Mouvement Démocrate party* (MoDem[53]), François Bayrou, has been proposing that a budgetary "Golden Rule" should be written into the constitution to prohibit governments from presenting budgets that operate at a deficit, outside periods of recession.

Conversely, a group of politicians and experts is arguing in favour of taking a radically different direction. At present, the leaders of the Front National are arguing for an economic strategy based on exiting the euro zone and on openly protectionist measures. However, so far these remain minority trends fuelled by protest groups and populist parties rather than by parties with a real chance of getting into power. As far as the Communist Party is concerned, it has already been a member of governing coalitions during the current constitution (5th Republic), from 1981 to 1986 and again from 1997 to 2002, but the majority vote system gives it little chance of exercising a major influence over the government's general direction. The same applies to the Green party ("Les Verts"), which was member of the ruling coalition from 1997 to 2002.

As far as the main government parties are concerned, the *Parti Socialiste Français* (PS) has not formally announced that it is renouncing class war – unlike its German counterpart, the SPD, when it ratified its Godesberg Programme in 1959. However, for the first time in its history, it declared itself officially in favour of a social market economy in its "Déclaration de principles" adopted on 14 June 2008.[54] In a more general way it has begun to adopt policies that are much closer to those of other European social democratic parties.

A major divide on the issue of deficit reduction in public policy

In France, opinion is fundamentally divided between two concepts of budgetary consolidation, splitting the two main ruling parties (UMP and PS) and the wider public.[55] On the one hand and largely on the UMP side, many experts and politicians believe that budgetary adjustment for deficit reduction is a central objective of utmost importance that forms the basis of the success of all the government's reforms.[56] The other argument, held particularly by the PS, is that it is important to prioritise other goals such as reducing unemployment; in this way they are defending an inverse causality in that they believe budgetary adjustment can only really be achieved through growth.

In this second category, the socialist candidate in the presidential elections of spring 2012 declared his desire to reduce the public deficit to % of GDP in 2013 and to rebalance the budget by the end of his term in 2017 based on a real GDP growth rate of 0.5% in 2012, 1.7% in 2013, 2% in 2014 and then 2.5% each year from 2015 to 2017. François Hollande has also called for renegotiation of the new European treaty agreed on 9 December 2011 and signed by 25 member states on 2 March 2012. His hope is that a renegotiated treaty will include measures to encourage growth and jobs and that the European Central Bank will shift its course to follow this direction. He also declared his intention of creating eurobonds.[57]

Stability of the eurozone: the need to create sustainable potential for growth

In any event, the predominant view in France at the beginning of 2012 was that the EU had made some important progress on the issue of budget discipline – as evidenced by the new treaty signed on 2 March

2012 – but that it was also imperative to increase the potential for long-term growth by redressing external imbalances in order to stabilise the eurozone.[58] At the end of the day, in the cases of Portugal, Ireland, Spain and especially Greece, the ultimate cause of the eurozone crisis was not the public deficit but private debt facilitated by the banking system, along with lack of competitiveness and current account imbalances.[59]

Beneath it all, French experts tend to cling to the idea of the "magic square" as an intellectual point of reference[60]. According to this concept, a country's macroeconomic policies should be aimed at achieving four main objectives that are difficult to reconcile: steady and adequate economic growth, full employment, price stability and balance of payments equilibrium. This idea of the "magic square" serves to underline the fact that price stability is necessary but inadequate and that – as far as the balance of payments allows – growth and jobs are two very important aims. However, economic and political decision-makers in France have traditionally tended to prefer growth to price stability.[61]

This is why French experts and politicians are generally in broad agreement on the idea that the stability of the eurozone requires a part of Europe's public debt to be pooled, whether in the form of eurobonds or, as Germany's "five wise men" propose in their latest annual report, in the form of a "debt repayment pact" (*Schuldentilgungspakt*)[62]. According to MoDem MP Sylvie Goulard, coordinator of the Economic and Monetary Affairs Committee at the European Parliament, the ultimate aim of a European bond market should be "to encourage member states to observe budgetary discipline".[63] Benoît Coeuré, former Deputy Director General of the French Treasury and chief economist at the Ministry of the Economy in Paris before joining the board of the European Central Bank in early 2012, believes that eurobonds can be useful but only as a medium-term solution coupled with a strict system of budgetary discipline and as the crowning achievement of the process of political and budgetary integration[64]. It should be emphasised that in France, unlike in Germany, very few experts or politicians believe that the financial markets constitute a necessary and adequate mechanism for disciplining countries that are in deficit by applying prohibitive interest rates and thus avoiding excessive deficits.

A stance that is largely in favour of regulating the financial markets

The fact is, if the "culture of stability" is tending to spread in France, the dominant culture is not (neo) liberal[65]: it adheres to the notion of a social market economy but not to the idea that deregulation of the financial markets and the flow of capital constitutes an end in itself. Moreover, Chancellor A. Merkel recently defended a similar position, saying: "We need more regulation of the financial markets. Speculation is an excess that needs to be tempered."[66] From this standpoint, the dominant economic culture in France – like its German equivalent, ordoliberalism – is different from the predominant neoliberalism that is currently of an Austro-American hue[67], following on from theoreticians such as Friedrich von Hayek and Milton Friedman. Whether or not they are calling for liberalism, experts and politicians in France and Germany have recently come to a broad consensus around a proposal such as the levying of a tax on financial transactions.

Belated awareness of the new roles played by exchange rates and wage policies in a monetary union

In the face of Milton Friedman's theories, they also have become aware of misdemeanours caused by excessively strong exchange rate fluctuations, and most of them take a favourable view of the European monetary union. It is true that the French-style "culture of stability" generally continues to give a fairly important role to changes in the exchange rates, all the more so because French exports are generally more sensitive to factors affecting price and competitiveness than German exports, which are more linked to non-price factors such as product quality, innovation, brand image, etc. In France, despite everything, only a minority of experts[68] and politicians are calling for an exit from the euro, as they hope that currency devaluation may make a lasting contribution to growth and jobs targets.

In France, there has been a rather belated but widespread realisation that, in a monetary union characterised by weak levels of public transfers and labour mobility between member states, competitiveness adjustments are generally made through changes to prices and wages, which reduces nominal progression in the least competitive regions or countries. Unfortunately, social dialogue remains less constructive and less balanced in France than in Germany, mainly due to the very low rate of unionisation (7.6% in 2008, compared to 19.1% in Germany and 17.9% across all OECD countries[69]), along with the fact that the unions are often very divided (unlike in Germany, there is no united union) and some of them are more interested in confrontation than negotiation. The prevalence of this culture of conflict rather than social consensus can also be seen in the number of strike days per 1,000 workers. This averaged around 30 in France between 2000-2008, less than Spain, Italy and Greece (almost 90) but a little more than the average for the EU-27 (around 28), and much higher than the UK (around 17) and Germany (less than 5), according to the adjusted figures published by the European Commission.[70]

A France that clings to certain concepts of the state, politics and social relations

In Germany, economists and politicians are basically looking for guidelines to ensure sustainable policies and, from this perspective, very often return to the concept of *Ordnungspolitik* (literally: politics of order) and focus on building consensus between the various levels and components of their society (*Länder*, social partners, etc.). In contrast, their French counterparts, in the name of their idea of democracy, remain much more culturally attached to the idea of public initiatives driven by a strong political will, incarnated by the central government[71] and at times focused on more discretionary actions, even though France has been experiencing a clear movement towards decentralisation over the last 30 years, and despite the fact that the authorities have grasped the fact that the country cannot be reformed by decree and that the social partners intend to have their say.

Having said that, this political culture in France also allows for a certain level of pragmatism and a capacity to react quickly when faced with unexpected events. Since the crisis befell the eurozone, many proposals have emanated from Paris that have significantly contributed to the major decisions taken by the EU to deal with the instability of the financial markets and, in the longer term, to establish a form of "economic governance" that is capable of correcting certain macroeconomic imbalances that generate instability (for example, the steps taken as part of the "six pack" adopted during the second half of 2011).

5. SURVEY RESULTS SHOWING HOW THE PUBLIC VIEW THE "CULTURE OF STABILITY"

The role of the "culture of stability" in the French public's mind can be studied using the results of surveys such as the Eurobarometer on subjects such as inflation and, more specifically, government debt.

A relatively strong sensitivity towards questions of inflation and government debt

According to the Eurobarometer survey carried out in autumn 2011, the subject of "price increases/inflation" is mentioned with the same frequency in France as in Germany, both in terms of it being a personal problem for the people surveyed and in terms of it as a problem for their country.[72] When asked which were the two main problems faced by their country at the present time, 20% of French people said "government debt", which was less often than the Germans (40% of those asked), but more often than the average for the EU-27 (17%).[73]

In the same Eurobarometer survey, in response to the idea that "the measures that need to be taken to reduce the public deficit and debt in our country are not a priority at the moment", the French (70%) disagreed much more often than the Germans (53%) and the rest of the EU-27 (51%).[74] This suggests that the French are conscious of the fact that restoring order to the public finances is progressing more slowly than on the other side of the Rhine. This interpretation is further supported by the following point: when faced with the statement "the measures that need to be taken to reduce the public deficit and debt in our country cannot be postponed", the French (83%) answered in the affirmative almost as often as respondents in the whole of the EU-27 (84%), though less often than the Germans (92% agreement).[75]

Acceptance of sacrifice is less pronounced on the French side of the Rhine

In view of the fact that the question on government debt was only asked as part of the Eurobarometer survey carried out in the spring of 2010, it is interesting to note how the number of positive responses increased in the space of just one-and-a-half years. In 2010, the replies in the affirmative stood at just 65% in France, compared to 74% across the EU-27 as a whole and 83% in Germany.[76] In other words, there has been convergence between France and Germany over recent months in this respect. However, the 2010 survey shows that the statement, "Reforms should be carried out that will benefit future generations, even if this means that today's generation has to make sacrifices" was only approved by 62% of respondents in France, slightly below the average for the EU countries (71%) and lower still than Germany (77%).[77] It would be interesting to know whether this gap has been maintained in view of the major budgetary consolidation measures taken in France since that time, particularly in the latter part of 2011, in face of the escalating crisis in the eurozone. In any case, it is likely that the limited acceptance of sacrifice in France is linked to the difficulties surrounding social dialogue, which tends to arouse feelings of mistrust.[78]

Overall, the responses to these surveys show that French opinions on the issue of debt and the national deficit are similar to those of most Europeans. There has been a heightened sensibility since the beginning of the eurozone crisis, bringing opinions closer to those of Germany, but it is also clear that there is a lower propensity for sacrifice on the French side of the Rhine.

Apart from the comparative surveys carried out by Eurobarometer, other studies have also thrown up some interesting results. A survey by IFOP carried out in August 2011 showed that a large majority of French people (78% of respondents) approve of the principle of a budgetary "Golden Rule" that is written into the constitution, irrespective of whether they are on the right (82%) or the left (74%) of the political spectrum. However, 68% of respondents believe it is first and foremost a PR exercise and political manoeuvring, and 86% of these added that this constitutional change would not stop the national budget from remaining in deficit for many years to come. In other words, the French seem to be very sceptical about the effectiveness of this measure, probably because of their mistrust of politicians.[79]

6. STRUCTURAL REFORMS UNDERTAKEN TO OPEN VARIOUS CHANNELS FOR INCREASING COMPETITIVENESS

Finally, the last group of elements relates to the structural reforms that have been implemented, announced or are currently under discussion with a view to increasing the competitiveness of the French economy by

various channels such as wage policy, the tax system or reform of the labour market.

The need for structural reforms, particularly in terms of restoring the country's competitiveness

In general, one of the elements demonstrating the relative importance of the culture of stability is the fact that policymakers are making medium and long-term decisions rather than just focusing on the here-and-now. Most recent changes that have been made seem to be going in the right direction in both France and the rest of the EU.[80] But nothing can be taken for granted and the success of this direction still remains to be seen: this is one of the recent messages from the rating agencies. In January 2012, Standard and Poor's downgraded France's rating (along with that of eight other countries in the eurozone and that of the European Financial Stability Facility), explaining that France's rating could remain stable at its current level if the authorities succeed not only in pursuing the reduction of the national deficit in a way that stabilises the public debt to GDP ratio over the next two to three years but also in implementing reforms designed to boost economic growth.[81]

Moreover, France was one of twelve countries chosen by the European Commission to be the subject of a more detailed analysis, with the first report appearing in February 2012 on the issue of economic imbalances between European countries.[82] In the case of France, the problems that were identified relate mainly to external imbalances. A first sign of this is a deterioration in the balance of payments current account, although the recorded deficit (-1.7% of GDP on average over 3 years) remains below the warning threshold (-4% of GDP). A second symptom is the fact that France is one of those EU countries – along with Belgium, Italy, Cyprus, Finland and the UK – whose share of the global market in goods and services declined the most between 2000 and 2010, demonstrating their loss of competitiveness within the global economy.

Structural weaknesses to be countered with appropriate measures

For France (as for Italy), the fundamental issue is to counter certain structural weaknesses: the thorny problems of public debt and a large external deficit, but also the risk of losing productivity gains and hence endangering future growth, the high levels of structural unemployment

and the inadequate employment rate. In principle, according to the analysis carried out by the economist P. Artus, the appropriate response consists of the following:

- modifying the weighting and structure of compulsory deductions to make them more favourable to jobs and growth and in particular by reducing the burden of social security payments;
- increasing cost competitiveness, which has declined compared to that of Sweden and Germany;
- improving the efficiency of public spending, particularly with regard to public sector employment;
- ramping up efforts to promote innovation and, to a lesser extent, higher education;
- acting to ensure that wage negotiations do not only relate to wages but also take employment into account at a time of high unemployment, deindustrialisation, lower cost competitiveness and reduced export markets;
- reshaping labour market policies in order to increase employment and bring the unemployed back onto the labour market by reducing the relative weighting of passive expenditure (unemployment benefit) and increasing active expenditure (training, monitoring the unemployed, etc.);
- reducing the obstacles to growth for businesses in terms of taxation, financing, regulation, relationship between SMEs and large groups, etc.[83]

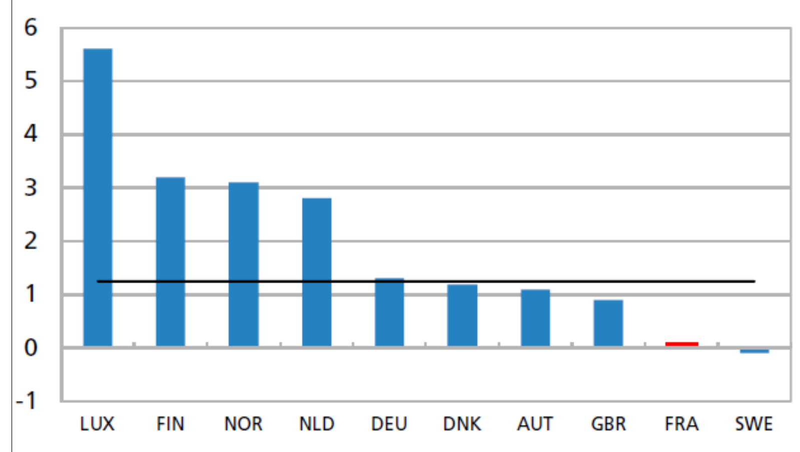
Many measures that have already been introduced or that are currently under discussion are taking this direction, particularly those mentioned earlier relating to budgetary and fiscal policy including pensions reform, limiting health insurance expenditure to an annual increase of 2.5% per annum via hospital reforms and converging public and private rates, not replacing a large proportion of public sector workers upon retirement and controlling local authority funding.

First example: pension reforms in 2010

The pension reforms that were introduced in 2010 stirred up a public outcry and a series of strikes, but in the end they went ahead. They have led to the legal retirement age (the age when pension entitlement begins) being progressively raised from 60 to 62 between now and 2018 4 months per year for a period of 6 years[84]). But the age at which a salaried employee can retire without taking a drop in pension if the contribution period has not been reached will be increased from 65 to 67 between now and 2023[85], whereas in Germany the progressive increase from 65 to 67 will be spread out until 2029. Moreover, the reference period for contributions in order to retire on a full pension will be 41.5 years from 2012. This is higher than in Germany, where the contribution period is currently 35 years, allowing people to retire on a full pension at the age of 63. Despite everything, the *effective* retirement age is on average a little lower in France (around 60) than in Germany (62.2). This discrepancy can be explained by demographic trends, which are more favourable in France than in Germany. Within the EU-27, France has the second-highest fertility rate (average number of children per woman during her reproductive life), second only to Ireland. All this shows that the latest pension reforms carried out in France, particularly since that carried out by F. Fillon, Minister of Social Affairs in 2003, are more significant that is sometimes thought compared to other similar countries.

According to the IMF, these changes will allow the French pension system to balance its books by 2019, working from an initial deficit in 2010 of almost 1.5% of GDP.[86] On this basis, the latest pension reforms – combined with a fairly favourable demographic outlook – put France in a good position when measured against other comparable countries in terms of predicted trends in public spending on retirement pensions (fig. 11).

Fig. 11: Growth in public spending on retirement pensions: projection for the period 2011-30 (changes in % points of GDP)



Source: IMF, France – Staff Report for the 2011 Article IV Consultation, Washington DC, July 8 2011 (p. 12), according to OECD Pensions at a Glance 2011 and according to the 2011-2014 stability programmes.

Second example: recent creation of the "pro-employment VAT" mechanism ("social VAT")

In June 2011, the European Council recommended that France should increase the efficiency of its tax system "through a move away from labour towards environmental and consumption taxes".[87] In November 2011, the IMF for its part advised France to shift a part of the direct tax burden to indirect taxation.[88] With these two recommendations in mind, in early 2012 France launched a mechanism that some people have termed "pro-employment VAT" and others "social VAT", and which consists of simultaneously reducing employers' social security payments and increasing the rate of value added tax (VAT). Its main aim is to improve the competitiveness of the "Made in France" brand, which will benefit from the reduction in employers' contributions, while the VAT increase will affect imported products but not exports. This measure was directly inspired by the German grand coalition's decision to increase VAT by three percentage points in January 2007, even though only one of these three points served to reduce social security contributions (unemployment contributions) as the other two-thirds were used to reduce government debt. In France's case, the National Assembly voted

on 22 February 2012 to increase the normal VAT rate by 1.6 percentage points, from 19.6 to 21.2%, with effect from October 2012 (unless the majority in the Assembly changed before then), while the reduced rate would remain unchanged.

This reduction in social security contributions in the sum of 13.2 billion euros would be financed by the VAT increase (10.6 billion euros) and by tax increases (universal social security contributions) on capital gains (dividends, rents, interest, etc.), in order to make the better-off contribute to lowering labour costs. The government hoped that this measure would allow the creation of 100,000 new jobs over the next 3 years.[89]

In summary, this report shows that France has in practical terms created a "culture of stability" that is similar to that of Germany and that often takes a long-term view as regards a series of indicators such as inflation, long-term interest rates, household savings and private debt. However, as far as the "culture of stability" is concerned, general patterns of behaviour in France continue to differ from those that prevail in other European countries such as Germany. These disparities tend to be rooted in the persistence of various structural, institutional and mental factors. With regard to the issue of public debt, for example, some of these differences can be explained by demographic changes, as concerns about not overloading future generations are linked to the population's ageing patterns.[90] Moreover, in France, wage increases and the pensions system are largely dependent on the particularities of the social dialogue.

However, these structural, institutional and mental factors are not set in stone, and the series of crises that have beset France since 2008 have brought with them some major re-evaluations. This analysis reinforces the theory that rebuilding the stability and sustainability of the French economy requires a review of the growth regime that has dominated the country for many years and which was clearly based excessively on borrowing and on policies focused on demand that favoured household consumption and social transfers for nearly fifteen years.[91] This kind of reorientation largely consists of strengthening the competitiveness of French manufacturing. However, global competitiveness does not only depend on price factors such as exchange rates, labour costs and taxation. In the long-term, it also depends on the quality of the offer, which comes back to elements such as innovation and staff training within

companies. Needless to say, the necessary reforms and structural changes will take time and should not be limited to budget consolidation and wage restraint.

1| *The views expressed are those of the author alone.*
2| *P. Praet, Member of the Executive Board and Chief Economist of the European Central Bank provides a good overview of this general idea in his article: Sound money, sound finances, a competitive economy – principles of a European culture of stability, which he presented at the Konrad-Adenauer-Stiftung conference on "Perspectives for a common stability culture in Europe", Berlin, 27 February 2012. See also P. Steinpaß, "Die deutsche Stabilitätskultur: Voraussetzung oder Hindernis für eine WWU-Governance?" in: Konrad-Adenauer-Stiftung [ed.], Der deutsche Weg aus der Krise, Deutsch-Französischer Dialog, vol. 6, Paris, 2011, pp. 117-133.*
3| *Cf. S. De Corte, Sustainable competitiveness, presentation made at the Konrad-Adenauer-Stiftung conference on "Perspectives for a common stability culture in Europe", Berlin, 27 February 2012.*
4| *Court of Auditors, Le rapport public annuel - Synthèses, February 2012, p. 11.*
5| *In its recent annual report, the Court of Auditors estimates that this target will be difficult to achieve without the introduction of new measures, particularly where it is based on a set of favourable assumptions on rates of GDP growth, revenue elasticity and spending reductions. Since the publication of this report (February 2012), new measures have been announced and the 2011 deficit has been shown to be a little weaker than initially forecast (5.2% of GDP instead of 5.7%).*
6| *See speech given by D. Migaud, President of the Court of Auditors, on the occasion of the press conference to unveil the Court of Auditors' annual report on 8 February 2012.*
7| *Court of Auditors, Le rapport public annuel – Tome I: Les observations, February 2012, p. 47.*
8| *Source: Le budget de l'État voté pour 2012 en quelques chiffres (Loi de finances initiale) http://www.performance-publique.budget.gouv.fr/*
9| *INSEE figures quoted in a Senate report; http://www.senat.fr/rap/r04-444/r04-4448.html*
10| *Court of Auditors, Le rapport public annuel – Tome I : Les observations, February 2012, p. 29.*
11| *OECD, Etudes économiques de l'OCDE : France 2011, Paris, 2011, p. 50.*
12| *Court of Auditors, Le rapport public annuel – Tome I: Les observations, February 2012, p. 42.*
13| *P. Artus, Vers une croissance durablement très faible dans les pays du Sud de la zone euro (France, Espagne, Italie…) ?, Natixis, Flash Economie, n° 61, 19 January 2012 ; R. Lallement, Frankreichs Wirtschaft nach der Krise – geschwächt, aber zukunftstauglich, DGAP-Analyse Frankreich, n° 10, Berlin, December 2010.*
14| *"The downgrade reflects our opinion of the impact of deepening political, financial, and monetary problems within the eurozone, with which France is closely integrated" (extract from Standard and Poor's press release of 13 January 2012: http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245327295020*

15| *Cf. A. Fabre, Les agences notent, l'Europe avance, Fondation Robert Schuman, Questions d'Europe, Policy paper n° 228, 13 February 2012.*
16| *Court of Auditors, Le rapport public annuel – Tome I: Les observations, February 2012, p. 49.*
17| *Cf. Court of Auditors, Le rapport public annuel – Synthèses, February 2012, p. 13.*
18| *Cf. P. Artus, Italie: la sévérité incompréhensible des agences de rating et des marchés financiers, Natixis, Flash Economie, n° 71, 23 January 2012, p. 7.*
19| *Cf. N. Couleaud et L. Mauro, Le patrimoine économique national en 2010 – Rebond marqué dû à la hausse des prix de l'immobilier, Insee Première, n° 1382, December 2011.*
20| *Cf. Credit Suisse Research Institute, Global Wealth Report, October 2011, Zurich, p. 42.*
21| *Cf. article by E. Freyssenet, "Un nouveau référendum envisagé par l'exécutif sur la règle d'or budgétaire", Les Echos, 15 February 2012. It should not be forgotten that in France referendums are the normal procedure for ratifying amendments to the constitution (in accordance with article 89 of the constitution). The procedure of uniting the two chambers at Versailles to form the Congress is officially only an alternative to this.*
22| *Cf. Catherine Mathieu and Henri Sterdyniak, Faut-il des règles de politique budgétaire?, OFCE, working document n°7, February 2012.*
23| *Cf. P. Artus, La règle d'or est-elle une bonne idée?, Natixis, Flash Economie, n° 940, 16 December 2011.*
24| *Court of Auditors, Le rapport public annuel – Tome I: Les observations, February 2012, pp. 32-33 and p. 60.*
25| *Cf. interview with the minister for the budget, public accounts and state reform, "Précresse: "Nous avons déjà fait voter l'essentiel des mesures pour atteindre l'équilibre en 2016"", Les Echos, 8 February 2012.*
26| *IMF, France Sustainability report, report created at the request of the G20, Washington DC, 23 November 2011.*
27| *D. Migaud, discussion at the time of the publication of the annual report of the Court of Auditors, February 2012, p. 5.*
28| *Cf. OECD, Revue de l'OCDE sur la gouvernance publique: France – Une perspective internationale sur la révision générale des politiques publiques, Paris, 2012, p. 17.*
29| *Idem, p.16.*
30| *Cf. Minister for the budget, public accounts and civil service, Rapport sur les prélèvements obligatoires et leur évolution, appendix to the finance bill for 2012, date of submission: August 2011, p. 14.*
31| *Court of Auditors, Le rapport public annuel – Tome I: Les observations, February 2012, p. 37 and p. 44.*
32| *Article by M. Castagnet, "La France a encore du chemin à faire pour réduire son deficit", La Croix, 9 February 2012.*
33| *The German tax system is sometimes called a "jungle", and an oft-repeated anecdote claims that 60% of all the world's documents relating to tax systems are written in German! Cf. article by P. Hahne "Der deutsche Steuer-Dschungeln", Die Welt, 16 July 2004.*
34| *"Cette instabilité ne peut être imputée entièrement à la crise économique: elle est un problème récurrent de la politique fiscale française." Extract from: E. Dussoubs and A. Imbert, Retour sur le "paquet fiscal" de 2007, working document from the Institut Montaigne, January 2012 (p. 8).*

35| *Conseil d'État, Rapport public 2006: Jurisprudence et avis de 2005. Sécurité juridique et complexité du droit, Paris, La Documentation française, 2006.*
36| *http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_oth_staid&lang=fr*
37| *This body believes it is necessary to abolish 15 billion euros of tax loopholes compared to the 2010 level; cf. Court of Auditors, Le rapport public annuel – Tome I: Les observations, February 2012, p. 60.*
38| *E. Dhont-Peltrault and R. Lallement, Investissements d'avenir et politique industrielle en Europe: quel ciblage et quelle sélection des projets innovant?, Centre d'analyse stratégique, La note d'analyse, n° 236, September 2011.*
39| *F. Schneider, Prognose zur Entwicklung der Schattenwirtschaft in Deutschland im Jahr 2012, IAW press release from 24 January 2012, Tübingen.*
40| *See article by C. Guélaud, "Lutte contre la fraude fiscale: l'essentiel reste à faire", Le Monde, 22 March 2012.*
41| *Cf. Transparence International France, Quelques avancées, des reculs: la lutte contre la corruption n'est toujours pas une priorité politique en France, five-year review of the fight against corruption, March 2012.*
42| *During the 2012 presidential election campaign, the Front de Gauche and the Front National proposed that the budget deficit should be financed by the central bank and not by the financial markets.*
43| *Cf. article by P. Fabra "La zone euro face au bazooka", Les Echos, 14 February 2012.*
44| *Cf. article by C. Lacombe "Il faudra plus que le verbe pour apaiser la zone euro", Le Monde, 15 April 2012.*
45| *See for example article by C. de Boissieu, "Quelle refondation pour la zone euro?", Confrontations Europe – La revue, January/March 2012, p. 11.*
46| *"Die massiven Interventionen der EZB haben die durch die Krise im Euroraum verunsicherten Unternehmen und Konsumenten zumindest vorübergehend beruhigt", according to the head of the economic stabilisation department of the DIW institute in Berlin, Ferdinand Fichtner, quoted in the article "Deutsche Wirtschaft schrammt an Rezession vorbei", DIW Wochenbericht, no. 9.2012, 29 February 2012, p. 19. "Angesichts der makroökonomischen Ungleichgewichte in der Eurozone, deren Unhaltbarkeit die Finanz- und Schuldenkrise offenbarte, sind die Dogmen der Bundesbank stark verblasst.", according to the DIW expert on financial and fiscal policy: S. Bach, "Lieber fünf Prozent Inflation als 100 Prozent Staatsverschuldung", DIW Wochenbericht, no. 9.2012, 29 February 2012, p. 20.*
47| *Cf. Bank for International Settlements, "European bank funding and deleveraging", BIS Quarterly Review, March 2012, pp. 1-12.*
48| *Cf. T. Brand, L'impact de la crise sur la conduite des politiques monétaire et budgétaire, working document of the Centre d'analyse stratégique, n° 4, September 2011, p. 31.*
49| *See article by the chief economist of Dexia Asset Management, A. Brender, "Les limites de la solidarité européenne", Les Echos, 29 March 2012.*
50| *Cf. the articles "La BCE pourrait prêter au FMI pour qu'il renforce le FESF" (Reuters, 17 November 2011) and "Des efforts s'imposent pour relancer la croissance" (Bulletin quotidien Europe, n° 10542, 31 January 2012).*
51| *See the articles "Résoudre la crise de la dette, un jeu d'enfant pour les Nobel d'économie" (Le Monde, 11 October 2011) and "Nobelpreisträger Sims: Europäer können von Amerikanern lernen" (FAZ, 27 October 2011).*
52| *Article by M. Wiegel, "Sarkozy entdeckt die deutschen Tugenden", FAZ, 5 October 2010.*

53| *The MoDem seat in the European Parliament within the "Alliance of Liberals and Democrats for Europe" (ALDE).*
54| *"Les socialistes sont partisans d'une économie sociale et écologique de marché, une économie de marché régulée par la puissance publique, ainsi que par les partenaires sociaux qui a pour finalité la satisfaction des besoins sociaux essentiels." (article 6) http://www.parti-socialiste.fr/le-ps/la-declaration-de-principes.*
55| *See for example A. Fabre and A. Lechevalier, Lerne sparen, ohne zu schrumpfen – Haushaltsdisziplin vs. Wirtschaftswachstum? Ein französisches Streitgespräch zur Schuldenkrise, DGAP analyse 3, 20 March 2012. Of course, this two-way split is not black-and-white, as in reality it sometimes also exists within a party such as the UMP.*
56| *"L'assainissement financier est bien la condition première du relèvement de la compétitivité à moyen terme.", Alain Fabre in his article entitled Les agences notent, l'Europe avance (Fondation Robert Schuman, Questions d'Europe, Policy paper n° 228, 13 February 2012, p. 3).*
57| *http://francoishollande.fr/le-projet/*
58| *This point has also recently been emphasised by the IMF: "To address imbalances and achieve strong, sustainable, and balanced growth, France will require additional fiscal consolidation efforts over the medium term and growth-enhancing structural reforms." (IMF, France Sustainability report, report issued at the request of the G20, Washington DC, 23 November 2011, p. 2).*
59| *This type of analysis is also very prevalent in the UK; cf. article by T. Barber, "Misdiagnosis of European crisis likely to deliver wrong solution", Financial Times, 5 January 2012.*
60| *Conceived in the early 1970s, this idea has generally been attributed to the British economist Nicholas Kaldor (magic square). The German finance minister of the time, Karl Schiller, helped to popularise the concept.*
61| *Cf. J.-F. Jamet, "EU Economic Governance: the French View", in: J.-F. Jamet, W. Mussler and S. de Corte, EU Economic Governance: the French and German Views, Research paper – Centre for European Studies, September 2011, p. 20.*
62| *Proposed by the Council of Economic Experts in Germany, this suggestion of a "debt repayment pact" picks up on the basic idea of eurobonds, as it consists of pooling a part of government debts – those exceeding 60% of GDP – into an ad hoc fund. Cf. Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (SVR), Verantwortung für Europa wahrnehmen, annual report 2011-2012, Wiesbaden, November 2011.*
63| *See article "Obligations de stabilité: une option qui doit être davantage prise en considération", dated 15 February 2012 on the ALDE group website: http://www.alde.eu/nc/fr/priorites/croissance-lutte-contre-la-recession/nouvelles-seules/article/stability-bonds-an-option-that-must-be-further-explored-37917/*
64| *See article "Le Parlement valide la nomination de Benoît Coeuré à la BCE" dated 14 December 2011 (http://www.euractiv.fr/parlement-valide-nomination-benoit-coeure-bce-article). For a German point of view in a similar vein, see T. Petersen, Stability has a price, Bertelsmann Stiftung, Spotlight Europe n° 02/2012, March 2012.*
65| *Cf. J.-F. Jamet, "EU Economic Governance: the French View", in: J.-F. Jamet, W. Mussler and S. de Corte, EU Economic Governance: the French and German Views, Research paper – Centre for European Studies, September 2011, p. 9.*
66| *See interview with Angela Merkel entitled "Pour l'Allemagne, la culture de stabilité n'est pas négociable", Le Monde, 19 May 2010.*

67| *Cf. F. Bilger, "La pensée néolibérale française et l'ordolibéralisme allemande", in: P. Commun [ed.], L'ordolibéralisme allemand – Aux sources de l'Economie sociale de marché, CIRAC, 2003, pp. 17-30.*
68| *See for example article by G. Lafay, J. Sapir and P. Villin, "Non, l'euro n'est pas sauvé!" Le Monde, 19 March 2012.*
69| *Data taken from the OECD.Stat online database.*
70| *Cf. European Commission, Industrial Relations in Europe 2010, Commission staff working paper, SEC (2011) 292 final, Brussels, 3 March 2011, p. 60.*
71| *In this respect, a key concept in France is "volontarisme" (a philosophy which stresses the importance of the will and action). Cf. O. Louis and D. Schwarzer (2010), "La politique économique de l'Union européenne – Une approche franco-allemande", in: C. Demesmay and A. Marchetti [ed.], La France et l'Allemagne face aux crises Européennes, Presses universitaires de Bordeaux, pp. 79-104.*
72| *European Commission, Standard Eurobarometer 76 – Table of results – First results, Public opinion in the European Union, TNS Opinion & Social, Autumn 2011 (fieldwork: November 2011; publication: December 2011), pages 21, 24 and 30.*
73| *Op. cit., p. 28.*
74| *Op. cit., p. 96.*
75| *Op. cit., p. 95.*
76| *European Commission, Eurobarometer 73 – Public Opinion in the European Union – Report, volume 2, TNS Opinion & Social, fieldwork: May 2010; Publication: November 2010, p. 102.*
77| *Op. cit., p. 97.*
78| *Cf. Y. Algan and P. Cahuc, La société de défiance – Comment le modèle social français s'autodétruit, Éditions de la Rue d'Ulm, coll. CEPREMAP, 2007.*
79| *Cf. article by E. Chavelet, "Hommes politiques. Les Français n'ont plus confiance", Paris Match, 30 August 2011 http://www.parismatch.com/Actu-Match/Politique/Actu/Sondage-Paris-Match-Ifop-Les-Francais-ne-font-plus-confiance-aux-hommes-politiques-327171/*
80| *"Là aussi, le changement doit être souligné: sous l'influence d'un fédéralisme budgétaire naissant, les politiques économiques nationales passent d'un pilotage néokeynésien à court terme à des politiques tendues vers la stabilité à moyen terme." extract from article by A. Fabre, Les agences notent, l'Europe avance, Fondation Robert Schuman, Questions d'Europe, Policy paper n° 228, 13 February 2012, p. 3.*
81| *Cf. Standard & Poor's, France's Unsolicited Long-Term Ratings Lowered To 'AA+'; Outlook Negative, 13 January 2012 http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245327295020.*
82| *European Commission, Alert Mechanism Report – Report prepared in accordance with Articles 3 and 4 of the Regulation on the prevention and correction of macro-economic imbalances, Brussels, COM(2012) 68 final, 14 February 2012.*
83| *P. Artus, France, Italie: quelles politiques structurelles?, Natixis, Flash Economie, n° 794, 24 October 2011.*
84| *The austerity programme put in place in November 2011 brought this date forward by one year, to 2017, corresponding to an increase of 5 months per annum.*
85| *The austerity programme of November 2011 also brought this date forward by one year, to 2022.*
86| *Cf. IMF, France Sustainability report, drawn up at the request of the G20, Washington DC, 23 November 2011, p. 5.*

87| Cf. European Commission, Council recommendation on the National Reform Programme 2011 of France and delivering a Council opinion on the updated Stability Programme of France, 2011-2014, SEC(2011) 806 final, Brussels, 7 June 2011, p. 7.
88| Cf. IMF, France Sustainability report, report drawn up at the request of the G20, Washington DC, 23 November 2011, p. 13.
89| Cf. interview with the minister for the budget, public accounts and state reform, "Précresse: "Nous avons déjà fait voter l'essentiel des mesures pour atteindre l'équilibre en 2016", Les Echos, 8 February 2012.
90| P. Artus, L'écart entre les situations démographiques peut-il expliquer l'écart entre les positions dominantes de politique économique en France et en Allemagne?, Natixis, Flash Economie, n° 212, 21 March 2012.
91| Cf. P. Artus, Contrairement à l'idée répandue, la France a mené une politique de la demande et non une politique de l'offre depuis la fin des années 1990, Natixis, Flash Economie, n° 763, 14 October 2011, and article by N. Baverez, "Fin de partie" (Le Monde, 29 November 2011) and editorial by H. Gibier, "Bas les masques" (Les Echos, 16 January 2012).

FISCAL STABILITY IN THE NETHERLANDS

Raymond Gradus | Hubert Beusmans

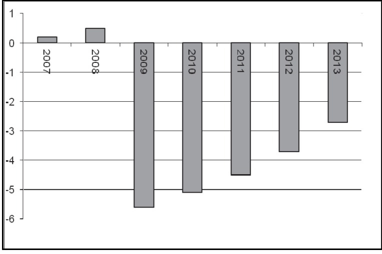
1. FISCAL POSITION OF THE NETHERLANDS

Prior to the financial crisis, the Dutch government could present sound finances. Just before the bankruptcy of Lehman Brothers in September 2008, the national budget was expected to be balanced in 2009 as it was also in 2007 and 2008. Furthermore a reduction in the public debt/GDP ratio to 38 percent , the lowest level in 35 years.[1] However, economic developments have changed dramatically, thereby causing substantial damage to the Dutch economy. In 2009, the deficit/GDP ratio decreased by almost 6 percent points to minus 5.6 percent and has only slightly improved in 2010 towards 5.1 percent (graphic I). Due to a late revision of budget forecast for 2009 that still referred to a positive economic outlook implying that wages and disposable income continued to rise, austerity measures set in too late. Therefore the debt/GDP ratio increased by nearly 15 percentage point from 45 percent in 2007 to almost 60 percent in 2008 mainly caused by financial interventions to save the large Dutch financial sector (graphic II). In order to stimulate the economy after the 2008 economic downturn the former government of Christian Democrats (CDA) and Social Democrats (PvdA) activated the so-called automatic stabilisators.[2] In addition, the government stimulated the

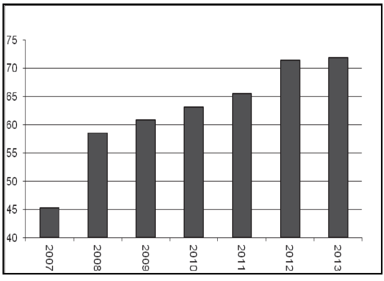
economy by initiating and fastening procedures for extra infrastructure works, these measures also concerned local government.

Graphic I: Dutch deficit/GDP ratio

Graphic II: Dutch debt/GDP ratio



Source: CPB (2012a)



Source: CPB (2012a)

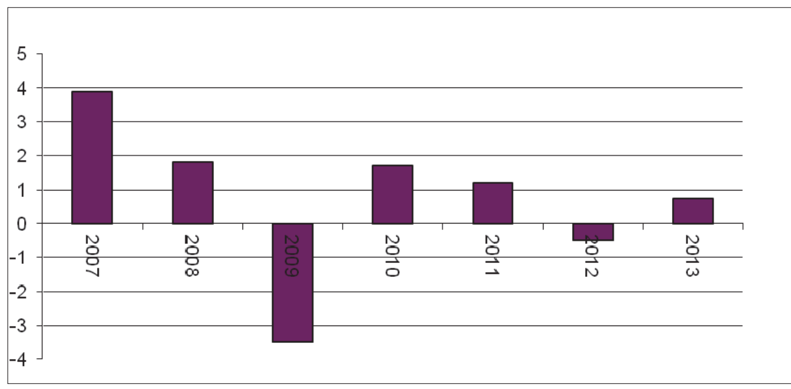
Nevertheless, the unexpected increase in public debt does not even include a potential loss of resources that might occur if some of the contingent liabilities to the financial sector materialise. However, the cabinet Balkenende IV (2007-2010) took some measures to fill the budget gap. It proposed an increase of age at which people receive first pillar state-subsidized old-age pension in two steps: from 65 to 66 in 2020 and then to 67 in 2025. However, before sending the legislation for this new scheme to parliament the Balkenende government broke down in February 2010.

After elections in June 2010 a government between Christian Democrats (CDA) and Liberals (VVD) supported by the populistic PVV took office at the end of 2010. It agreed on an austerity package of 18 billion euro's (3 percent GDP) in the period between 2011 and 2015. In addition, the government took the same measures on the old-age state pension. After consulting the social partners in 2010/2011 the government decided to raise the pension age to 67.[3] The agreement and the sustainability measures were not supported by the PVV, but by the Social Democrats (PvdA). Despite these austerity measures and reforms, Dutch deficit/GDP ratio in 2011 was 5.0 percent and will only be slightly better in 2012 with 4.6 percent (graphic I).

2. ECONOMIC GROWTH

The current European recession has effected the Dutch economy badly again and seems to hit the Netherlands harder than for example Germany and Finland. Especially the German economic development is interesting as it was at the beginning of the century "der kranke Mann" in Europe and at this moment Germany according to Van Paridon is the strongest economy of Europe.[4] What kind of reforms Germany made last decade? According to Van Paridon three factors (i.e. structural reforms in entrepreneurship, moderate wage development and reforms in the welfare state) seem to be important for the positive growth figures of Germany. These structural reforms of German economy started in the aftermath of the reunification in the 1990s. For the Netherlands the 1990's were years of high consumption levels, there was no stimulus for any long term reforms. According to the March forecast of the Dutch Central Planning Bureau (CPB), in 2012 the Dutch GDP will decrease by 0.75 percent after a modest growth in 2010 and 2011. In addition, the Dutch economy will slightly improve in 2013 with a GDP growth of 0.75 percent (graphic III).

Graphic III: Dutch GDP growth rate



Source: CPB (2012a)

Interestingly, in the beginning of this century the Dutch GDP growth rate was comparable with the GDP growth rate in Germany. Nowadays the Dutch GDP growth is substantially lower. Especially, the domestic spending of the Dutch economy is weak. In 2012 Dutch consumption decreases by -1 percent points and for 2013 it is assumed to increase by

0.7 percent points. This is totally different from the last decades, where consumption was one of the main drivers of Dutch growth. According to the CPB lower income and wealth effects are the cause for this weak consumption figure.[5] Also other elements of private spending such as capital and property investments are weak.

By the end of the 1990s, when many women joined the labour market and housing prices raised quickly, family consumption contributed to GDP growth by more then 1 percent a year (consumption as percentage of total GDP growth was 1.4 percent during the period 1996-2000, 0.4 percent during the period 2001-2005). After 2000 this effect was significantly smaller and by 2006 private consumption did not contributed to GDP growth anymore. During the financial crisis it was mainly public spending which influenced internal expenditure and had a positive impact on GDP growth.[6]

Lower income effects are caused by the current modest increase in employment. Wealth effects are mainly caused by the current state of the housing market. Dutch unemployment will rise from 4.5 percent in 2011 to almost 6 percent in 2013. More important, labour supply will shrink in 2013 due to labour hoarding effects. In addition, prices in the Dutch housing markets have decreased by more than 10 percent points since 2008 and the number of house selling is dropping dramatically as well. Therefore, structural measures for labour and housing market reforms must be necessarily introduced by the Dutch government.

Based on the coalition agreement in 2010 (CDA/VVD), the deficit ratio for 2013 was forecasted to fall to roughly 2 percent. However, the CPB estimate in March 2012 predicted a 2013 deficit ratio of 4.6 percent, implying additional austerity measures of 2½ percent GDP in order to meet the 3 percent target of the Stability and Growth Pact (CPB 2012b). This figure takes into account second round effects. However, the negotiations between the government and the PVV on additional measures for the remainder of the coalition period broke down in April 2012 and new elections were scheduled to take place in September 2012. Fortunately, on April 26th, only a few days before the deadline for the Stability Programme,[7] the caretaker government managed to agree on a 12 billion austerity package for 2013 after winning the backing of three left-leaning opposition parties.[8] In addition according to estimations of CPB (2012) the deficit/GDP ratio fell to -2.7 percent GDP.

3. PUBLIC OPINION

Let us consider the opinion of Dutch public towards 3 percent target in 2013. The poll of Maurice de Hond weekly carried out in the Netherland serves as reference.

Table I: Pole Dutch voters and SGP-targets.

	Voting behavior elections 2010							
	All	PVV	VVD	CDA	D66	PvdA	SP	Groen links
	in %							
The Dutch Government should commit to the 3 percent rule of the SGP.	77	70	92	94	81	62	52	66
It's a letdown for the Netherlands that we now have an excessive budget deficit our self.	65	70	66	49	79	64	61	67

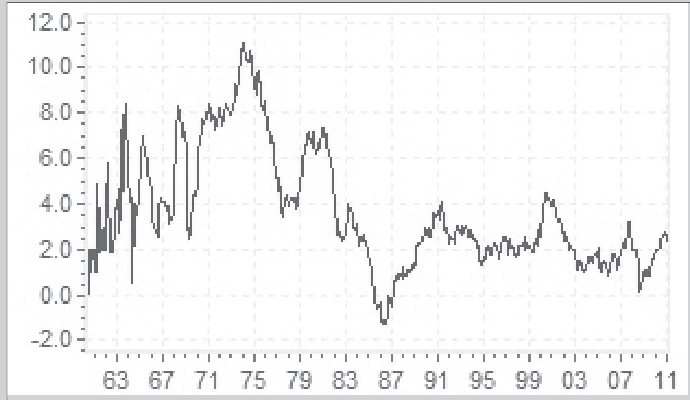
Source: www.peil.nl (March 2012)

Interestingly, 77 percent of Dutch population wants to reach the 3 percent-target. In addition, 65 percent stated, it's a letdown for Dutch government not reaching the 60 percent debt/deficit. Between political parties some remarkable differences should be emphasized. Voters of Christian Democrats (CDA) and Liberals (VVD, D66) support the SGP targets in a large majority. Voters of Social Democrats (PvdA), Green Left (Groenlinks), Socialistic party (SP) and Populists (PVV) are less convinced that the goals of the SGP in 2013 should be reached. When appointed in 2010 the government set the goal to reach a balanced budget again in 2015. However, by the new debt crisis it is hard to reach this goal in 2015. Too many austerity measures can harm Dutch economic recovery. In order to foster our reputation we must present the European Commission a solid and realistic plan to reach the 3 percent rule in 2013 and a balanced budget in the medium term.

Inflation

Inflation is not heavily debated in the Netherlands and seems to be of greater concern for Germany than it is for the Netherlands. However, it is interesting to see that Dutch inflation, although it has been relatively stable around 2 percent since the beginning of the 1980s, raised between 1999 and 2001 to 4.2 percent.

Graphic IV: CPI Dutch Long Term[9]



Source: Global-rates.com

High economic conjuncture dominated the Netherlands in the 1990s. The main reasons were the internet bubble and the substantial increase in housing prices. This was followed by a period of low economic conjuncture which in the Netherlands seems to be deeper and longer than in many Western countries. One of the reasons for this was he government policy in the 1990s. The Government used incidental revenue of windfalls for structural expenditure. It was mainly spent on internal healthcare, education and structural expenditure in security and caused tensions in the labour market. As a result government spending was structurally too high. By the time unemployment and inflation raised and consumption decreased, economic growth stagnated.

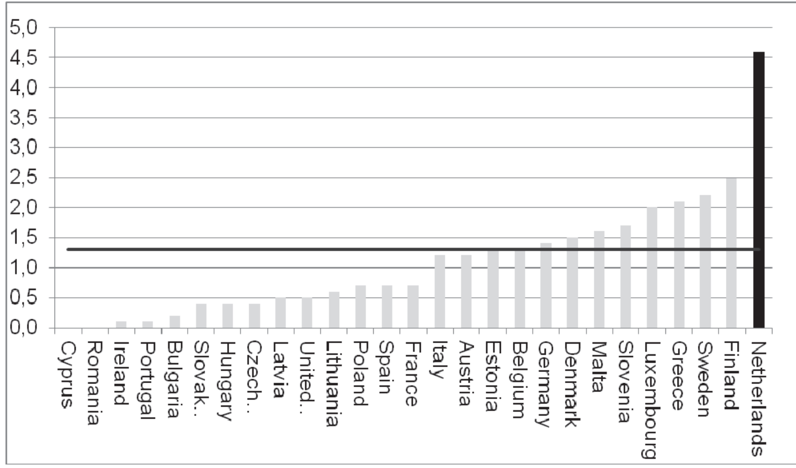
4. STRUCTURAL REFORMS

However, the negotiations between the government and the PVV about additional measures for the remainder of the coalition period broke down in April 2012 , the Dutch government and PVV disagreed about reforms and additional austerity steps for the remaining part of the coalition period and new elections will take place in September. Based on a temporary agreement between CDA, VVD, D66, GL and CU some austerity measures implying 3% in 2013 and short-term reforms on housing and labour market were taken in the last week of April.[10]

Yet, the figures presented above show the urgency of a long-term austerity package combined with structural reforms. The German case shows that especially labour market reforms can be helpful in order to stimulate economic growth. A more activating welfare system will reduce public spending and is also conductive to labour force participation. Labour market reforms must have high priority and are necessary in order to modernise the Dutch labour market. However, such reforms are very difficult to implement since the populistic PVV and opposition parties such as the Social Democrats and Socialistic Party are opposing any reforms. Also further reforms on the housing markets are hard to enforce. Nevertheless, the Dutch economy faces both households and the bank sector in debt, which should be tackled as well. The mortgage debt being very high in the Netherlands may become a source of instability, for example if interest rates go up or if unemployment rises drastically.

Finally, there are long term problems which the Dutch government has to deal with. First, according to 2009 EU forecasts of the costs for Dutch long-term care will raise by 4.5 percentage point of GDP between 2010 and 2060, more than three times the EU average and much larger than for example in Germany (graphic V). The Dutch personal responsibility and responsibility of the family for long-term care is very limited, and this is not sustainable in the long run.

Graphic V: Change in long-term care 2010-2060 (% GDP)



Source: EU (2009)

Second, a rising demand for care will also face a tighter labour market. The need for medical and educational professionals will grow rapidly in the coming decades thereby facing a shrinking supply due to an ageing society. Regarding this outlook a labour market reform appears to be highly necessary. Moreover, the need for a more efficient organisation of health care is not only based on costs, but also on social causes.

Third, tax and housing market reforms. Dutch debt culture, related to the housing market, will be fundamentally broken by introducing a social flat tax. For this reason the Dutch fiscal system should be drastically reformed. This should be done by setting-up a flat tariff and a rise for top incomes (solidarity levy). Importantly, mortgage will be deducted against the marginal flat rate. There are several advantages to this reform. The tax system will become more simple. Flat tax will make it more attractive to lend less. Different tax boxes of the Dutch fiscal system will be brought nearer to each other. It concerns tax on labour income and tax on assets capacity. This means that the pivot of financing your own house or company with as much as possible borrowed money will be less. It is therefore stimulated to redeem the mortgage debts. Therefore, it creates economic growth and employment.

5. CONCLUSION

Public finances have deteriorated since the crisis started in 2008. The Dutch agenda for the long term should be one of sound public finance and clever structural policies especially focused on the labour market, a more focused role of the state for health care and restraining trust in the housing market. In the budget agreement from April 2012 the first necessary steps towards a recovery of public finances have been taken. However it will be import that additional reforms will follow.

1| *Proposed national budget (Miljoenennota): presentation of the financial position of the nation for a specified period (often a year), based on detailed estimates of planned or anticipated expenditure during that period and proposals for financing it.*
2| *Also the (orthodox) Protestant party, CU, supported this government.*
3| *Pension agreement June 2011 between social partners and government.*
4| *Van Paridon K., "Duitse economie: krachtig herstel, nu sterk genoeg", in: Internationale spectator (March 2012) pp. 141 – 145.*
5| *Wealth effect is an increase (or decrease) in spending that accompanies an increase (or decrease) in perceived wealth.*
6| *CPB, Centraal Economisch Plan (2012), p. 53*
7| *This concerns the Stability Programme that needs to be submitted as part of the requirements for the Stability and Growth Pact.*
8| *These parties are Groenlinks (Green Left), D66 and the CU.*
9| *CPI refers to the rate of inflation based on the consumer price index. CPI shows the change in prices of a standard package of goods and services which households purchase for consumption. In order to measure inflation, an assessment is made of how much the CPI has risen in percentage terms over a give period compared to the CPI in a preceding period. If prices have fallen this is called deflation (negative inflation).*
10| *Reforms highlights of Stability programme on 26th of April 2012: a step-wise increase in the retirement age starting in 2013 and leading to a retirement age of 66 in 2019 and of 67 in 2024, employers are expected to pay unemployment benefits for the first six months and steps are taken by simplifying dismissal procedures and in house market only mortgages based on an annuity schedule over a period of 30 years are deductible. In addition, the transaction tax for houses will be lowered.*

SPAIN'S STABILITY PROGRAMME

Paloma Ferrero de Paz

1. ECONOMIC DATA

Spain's national debt is the total of all securities issued by the treasury, including treasury bills (3, 6, 12 or 18 months), short-term (3 or 5 years) and long-term treasury bonds (10, 15 or 30 years)

Evolution of Spanish National Debt

Year	Million	GDP
2010	641,802 €	61.00%
2009	561,319 €	53.30%
2008	433,611 €	39.80%
2007	380,661 €	36.10%
2006	389,507 €	39.60%
2005	391,083 €	43.00%
2004	388,701 €	46.20%
2003	381,591 €	48.70%
2002	383,170 €	52.50%
2001	377,806 €	55.50%
2000	373,506 €	59.30%
1999	361,556 €	62.30%
1998	345,953 €	64.10%

Source: Eurostat

As can be seen from this table, Spain's national debt stands at 61% of GDP.[1] .This ratio cannot be considered low, but it needs to be looked at in the context of other European countries, whose ratios are shown in the table below. From this it can be seen that, in 2010, Spain's national debt (expressed as a percentage of GDP) was actually lower than countries like France, Germany, Great Britain and Belgium, while Italy and Greece had a national debt that exceeded their GDP. Also, Spain's government debt is rated in the top category by the three rating agencies, Moody's, Fitch and S&P. Admittedly the top category is sub-divided into three levels and Spain is considered to be on level 3, but nevertheless, the rating agencies clearly believe that there is a certain amount of security to be held in Spain's debt.

Government debt in Europe 2010

Country	Million	% of GDP
Spain	641,802.00 €	61.00%
Germany	2,061,794.70 €	83.20%
United Kingdom	1,353,278.00 €	79.90%
France	1,591,169.00 €	82.30%
Italy	1,842,826.00 €	118.40%
Portugal	161,256.50 €	93.30%
Belgium	340,738.50 €	96.20%
Cyprus	10,652.60 €	61.50%
Denmark	102,183.10 €	43.70%
Estonia	956.70 €	6.70%
Finland	86,975.00 €	48.30%
Greece	329,351.00 €	144.90%
Hungary	78,249.90 €	81.30%
Ireland	147,988.00 €	94.90%
Iceland	9,286.20 €	92.90%
Latvia	8,027.40 €	44.70%
Malta	4,250.40 €	69.00%
Holland	369,894.00 €	62.90%
Norway	141,218.40 €	44.00%
Poland	195,425.40 €	54.90%
Romania	37,409.30 €	31.00%
Sweden	146,467.00 €	39.70%

Source: Eurostat

Since the crisis *Spain's risk premium* (the increment in interest rates for loans in Spain compared to Germany) normally ranges from 300 to 365 basis points. This is a high risk premium, because the cost of financing is high. Ideally, Spain would like to achieve a risk premium of around 150 to 160, similar to that of France.

Evolution of Spain's risk premium

Date	Premium	Var
3 April 2012	**365**	10
2 April 2012	**355**	-1
30 March 2012	**356**	-9
29 March 2012	**365**	16
28 March 2012	**350**	4
23 March 2012	**351**	-8
22 March 2012	**358**	16
21 March 2012	**343**	24
16 March 2012	**315**	-7
29 February 2012	**317**	-7

It is interesting to note that Italian government debt (similar to that of Greece, though slightly lower) is higher than the country's GDP, and yet Italy's risk premium is only slightly higher than that of Spain. Neither a change in the Spanish ruling party, nor drastic structural adjustment policies (labour reform), nor recently presented budgetary plans seem to have satisfied the markets, as the risk premium has now broken through the 365 basis point mark. It is not only the markets that have lost confidence in Spain, but its people have too. The Corruption Perceptions Index ranks countries by "corruption levels, based on expert analysis and opinion polls" on a scale of 0 to 10, with 0 meaning that the public sector is considered to be highly corrupt, while a value of 10 means that corruption is considered to be very low indeed.

Over the years, Spain has begun administering its public sector in a much more transparent way, with the result that its score in the Corruption Perceptions Index (CPI), which was just 4.35 in 1995, had gone up to 6.2 by 2011. However, the increase in its index score over the last 17 years has been irregular and not that significant. There was an improvement between 1995 and 2005, when it achieved a score of 7.

However, the score has deteriorated since 2005 and, at 6.2, is now back at its 1998 level.

Year	GERMANY		SPAIN	
	Position	Score	Position	Score
2011	14	8	31	6.2
2010	15	7.9	30	6.1
2009	14	8	32	6.1
2008	14	7.9	28	6.5
2007	16	7.8	25	6.7
2006	16	8	23	6.8
2005	16	8.2	23	7
2004	15	8.2	22	7.1
2003	16	7.7	23	6.9
2002	18	7.3	20	7.1
2001	20	7.4	22	7
2000	17	7.6	20	7
1999	14	8	22	6.6
1998	15	7.9	23	6.1
1997	13	8.23	24	5.90
1996	13	8.27	32	4.31
1995	-	8.14	-	4.35

Source: www.transparency.org

There is no doubt that there is corruption in Spain's public sector, and it seems to start with the country's leading politicians. Over the last 5 years, a number of current and former politicians have been to court to face allegations of misuse of authority, corruption, tax evasion and other offences committed while working in public office, all with the aim of lining their own pockets. There has been evidence of corruption amongst all the political parties and even the royal family has been involved. Corruption is widespread in the country. Based on figures published by the public prosecutor's office, the newspaper *El Mundo*[2] has calculated that over the last 10 years more than *4.1 billion Euros have been stolen* from municipal authorities, local authorities and other public bodies. The actual amount is no doubt much higher than this calculation. Opinion polls suggest that two-thirds of Spaniards believe that there is corruption in their local authorities, towns and cities.

Based on this, we can assume that the figures on tax evasion are not any better. In Spain, no official reports have been published on tax fraud, but there have been studies and data that give some indication of the size of the problem and which suggest that the overall figure for tax fraud ranges between 20 and 25 per cent of GDP, double the EU average.

In January 2012 the management consultancy company i2 Integrity published a study into tax evasion which suggested that *unpaid tax in Spain amounted to 70 billion Euros per year, approximately 23% of GDP,* the equivalent of the country's total healthcare budget. "Preferred" forms of fraud include avoiding paying value added tax, writing invoices for non-existent purchases, "black market" deals, obtaining subsidies under false pretences, failing to provide contractually agreed services, faking insolvency, fraudulent international dealings, non-declaration of capital and setting up bogus companies.

A report into combating tax fraud that was based on IRPF income tax statistics for 2009 and prepared by Ministry of Finance staff in the GESTHA working group, suggested that *in 2010, large manufacturers and companies evaded 42.711 billion Euros in taxes. This represents 71% of all cases of fraud in Spain.*

2. FISCAL POLICY

On 1 January 1999, the Economic and Monetary Union became Spain's main point of reference and budgetary stability became the main long-term objective of its public finances. In light of this new situation, the Spanish parliament initially passed the Budget Stability Law 18/2001, the Budget Law 5/2001 as an addendum to the Budget Stability Law, and later the Budget Law 3/2006, a revision of the Budget Law 5/2001 of 15 December and also an addendum to the Budget Stability Law. This was eventually all reflected in the revised version of the *Royal Decree Law 2/2007 of 28 December, in which the revised version of the Budget Stability Law was ratified.*

In a country as decentralised as Spain, a great deal depended on ensuring that all public administrations were implementing the stability programme. With this goal in mind, the Spanish parliament passed the Budget Stability Law contained within the Royal Decree Law 2/2007, which had ratified this revised version of the Budget Stability Law. Included in the law was a new procedure for establishing stability goals for

regional public administrations and their respective public sectors. In this way, the stability goals for each of the independent administrative bodies were agreed with the Ministry of Economy and Finance in bilateral discussions, even though, at the end of the day, it is down to the *Cortes Generales* (the national parliament) and the government to make the important decisions concerning economic policy.

However, Spain's acceptance of, and commitment to, budgetary stability only really became concrete with *constitutional reforms* aimed at reducing the budget deficit in 2011 through a pact between the two largest political parties. This pact, agreed between the ruling PSOE party and the opposition PP, led to the new Article 135 of the Spanish constitution.

The budget deficit and public debt are now bound by limits set by the EU for its member states. From 2020, budget deficits must not exceed 0.4% of GDP, unless there are extraordinary circumstances. This deficit percentage rate is not specified in the constitution, but the latter does include a duty to maintain a balanced budget. However the 0.4% rate is to be included in a budget law that needs to be passed by June 2012, irrespective of which party is in government.

As a result of the agreement, neither the state nor the individual regions are allowed to go into structural deficit and government debt is not allowed to exceed targets set by the European Union. These limits will come into force from 2020 and, as a result, the various administrations are now obliged to reduce their deficits until the limits specified in the Budget Law for 2020 have been met. This agreement underlines the need for reforms to ensure sustainability in the economy and society in general. The deficit limit of 0.4% of GDP applies to all the administrations. As is the case in Germany, this limit may be exceeded in the event of a natural disaster, economic recession or other extraordinary emergency situation.

However, the constitution does not specify which minister is responsible for this. Article 92 states that the government is made up of the President of the Government (who fulfils the role of Prime Minister), the Vice-President, if any, and the appropriate ministers. Only the role of President of the Spanish Government is specified, which consists of leading the government and coordinating the functions of the remaining members of the government.

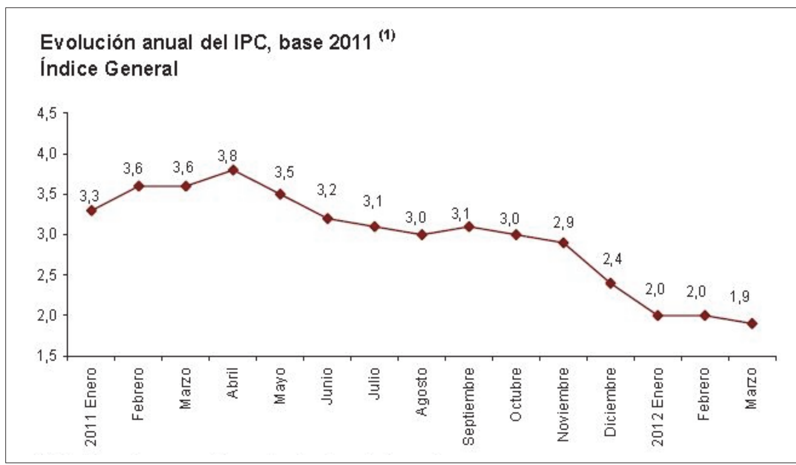
After the most recent parliamentary elections on 20 November 2011, the new government, formed by the Partido Popular, created the *Ministry of the Treasury and Public Administration Services* and a Department of General Public Administration tasked with proposing and implementing government policy in the following areas: public finances, budgets and expenditure, publicly owned companies, management of financial systems and cooperation with autonomous and regional administrations, support for delegations and government representatives, public service, work in the public sector, public sector staff training, reform and organisation of general public administration, supervision of conduct and procedures, development and expansion of electronic administration, assessment of public banks, improvements to management and the quality of services. For its part, the *Ministry of Economic Affairs and Competitiveness* is responsible for government economic policy and the recommendation and implementation of reforms to improve competitiveness, scientific research, technical development and innovation in all areas, and is also largely responsible for trade policy and business support.

3. ECONOMIC POLICY

The National Institute of Statistics (INE) is the government body responsible for compiling and publishing monthly data on the inflation rate, with the help of the Consumer Price Index (CPI). A comparison of the monthly data over the last 12 months shows that the trend is downwards.

National Consumer Price Index: CPI

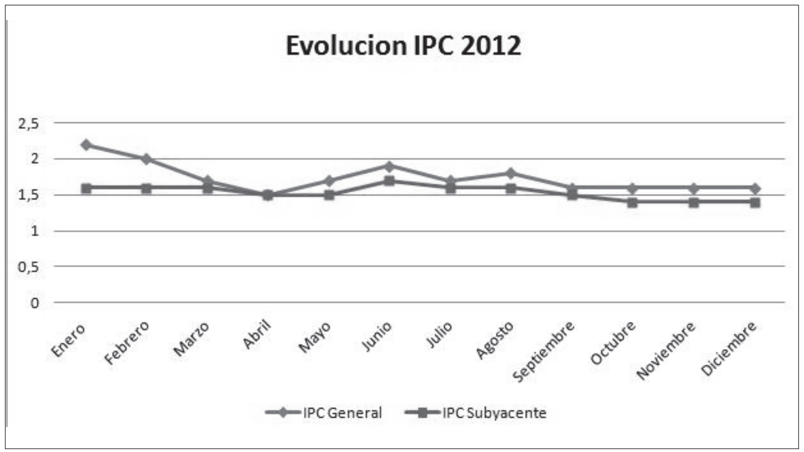
Period		Variation
February 2010	to February 2011	3,6
March 2010	to March 2011	3,6
April 2010	to April 2011	3,8
May 2010	to May 2011	3,5
June 2010	to June 2011	3,2
July 2010	to July 2011	3,1
August 2010	to August 2011	3,0
September 2010	to September 2011	3,1
October 2010	to October 2011	3,0
November 2010	to November 2011	2,9
December 2010	to December 2011	2,4
January 2011	to January 2012	2,0
February 2011	to February 2012	2,0



According to forecasts by FUNCAS (*Fundación de las Cajas de Ahorro*, Foundation of Savings Banks), the CPI in 2012 will drop, especially in the first months of the year, before stabilising at around 1.6%. This value would suggest that inflation should not be a factor that leads to instability in the markets.

Therefore inflation in Spain in 2012 is expected to remain stable at an acceptable level of less than 2%. The table shows the inflation trend for 2012, as predicted by FUNCAS. The figures are shown in graph form below.

Year	Month	CPI	
		Monthly	Yearly
2012	January	-1.0	2.2
	February	0.0	2.0
	March	0.5	1.7
	April	1.0	1.5
	May	0.1	1.7
	June	0.1	1.9
	July	-0.7	1.7
	August	0.2	1.8
	September	0.1	1.6
	October	0.8	1.6
	November	0.4	1.6
	December	0.1	1.6
	Yearly average	--	1.7



Evolution of Consumer Price Index (CPI) 2012 (blue: overall CPI , red: baseline)

In light of the Spanish government's latest forecasts predicting negative growth in GDP and high unemployment figures, which in the government's estimation are unlikely to fall in the short-term, it would appear that we may be on the verge of seeing a period of stagflation. However, the Spanish government rules out this possibility. The Secretary of State for Economic and Business Affairs, Fernando Jiménez Latorre, confirmed that the Spanish economy was in recession in the first quarter of 2012, but ruled out the possibility of stagflation in light of the expected stability in price increases (the CPI should drop in the coming months), and also expected that inflation should not pose a serious problem during the recession.

On 1 June 1994, Spain passed the Law of Autonomy of *the* Banco de España in line with the EU Treaty. The law specified four basic principles covering the work of the bank in order to guarantee its autonomy.

1. Public authorities are not permitted to overdraw their accounts with the Banco de España, even on a temporary basis, as this would effectively be bypassing the bank's sole right to issue money.

2. As an additional precautionary measure, the Treaty on Economic and Monetary Union does not permit the Spanish central bank to buy Spanish government bonds directly, irrespective of the fact that it can buy them on the secondary market.

3. The principle of autonomy also dictates that when it comes to monetary policy, the Banco de España is not subject to instructions from the government or the Ministry of Economics and Finance, and so can focus its policies on the main objective of stabilising prices.

4. The term of office of the governor of the bank should be relatively long and not renewable and grounds for termination should be strictly limited. Each term of office is 6 years and the appointment of the governor is made on the recommendation of the prime minister, which is perhaps the main political aspect of the appointment.

According to the Law of Autonomy of the Banco de España referred to above, the bank's responsibilities include the holding and administration of foreign currency and gold reserves that have not been transferred to the ECB; the smooth running and stability of the financial system, monitoring of the solvency of financial institutions and their compliance with the regulations, and advising the government. Minister of the Economy and Competitiveness, Luis de Guindos, will present plans for restructuring the financial system which he is working on in conjunction with experts from the Banco de España. These plans should establish the standards for the reorganisation, recapitalisation and restructuring of banks and savings banks and will be implemented in accordance with guidelines set by the Banco de España.

The Law of Autonomy of the Banco de España specifies that the Banco de España is responsible for providing financial services relating to public debt on the terms agreed between the Ministry of Finance and the autonomous regions that require these services, and that it should use all the technical means at its disposal to support the process of issuing, redeeming and administering government debt in general. However, it *prohibits buying government bonds directly from the issuer,* and, as a result, government securities may only be purchased on the secondary market in order to carry out its monetary policy responsibilities.

4. THE IMPORTANCE OF STABILITY POLICY IN THE ELECTION MANIFESTOS OF THE POLITICAL PARTIES

On 20 November, there was a general election in Spain. There is no doubt, that the one party that stood out during the election campaign for its commitment to stability and compliance with the debt cap set by the European Union was the *Partido Popular* (PP)[3]. This commitment was clear in Mariano Rajoy's introduction to the party's election manifesto, which referred specifically to austerity measures in dealing with the country's debt. In the manifesto, public debt is described as being "an impediment to economic recovery and the creation of jobs and an additional obstacle to the financing of private business." In light of this diagnosis, the manifesto recommended reducing the structural deficit in line with the country's commitments to the European Union. More importantly, in his inaugural address, Mariano Rajoy made it clear that "budget stability is one of the country's most important goals. Constitutional reform is fundamental to this aim and the first law that we will pass will be the law on budget reform."

Spain's Socialist Party (PSOE)[4] also defended the principle of budget stability in much the same way as it wants to protect public services. In the debate between the candidates during the election campaign, Alfredo Perez Rubalcaba accused Mariano Rajoy of no longer being able to guarantee education and healthcare services because of the Partido Popular's proposed policy on reducing government debt[5] and put forward three courses of action for maintaining budget stability:

1. Tax reform: a higher degree of progression in the distribution of the tax burden.
2. Budgetary discipline and support for constitutional reform to guarantee financial and political stability.
3. Combating tax fraud.

In section 6 of their election manifesto, the United Left (IU)[6] claimed that while public expenditure must be curbed, reducing government debt would not necessarily lead to economic recovery. The party questioned the very legitimacy of the country's national debt, claiming that a large portion of it was the result of "fulfilling commitments to buy weaponry or supporting financial institutions and their business activities, which have largely proven to be speculative". The leader of the party, Cayo Lara, said in an interview that it was necessary "to carry out an investigation into Spanish debt to see just how much of it is the result of expenditure, and how much has been paid out to support the banks. Our national debt is below the European average"[7].

Amongst the nationalist parties in parliament, *Convergencia i Unió* (CIU)[8] saw the reduction of the country's deficit as being the product of an improvement in the effectiveness of central government and economic growth. In this respect they were at odds with the other parties. For its part, the Basque Nationalist Party (PNV)[9] dedicated a whole chapter on page 23 to "Economic and budgetary stability," in which it defined government debt as "a strategic variable of economic policy par excellence." For the PNV, the significance of the budget deficit is the result of weak and inflexible economic policies that have affected the economy's standing. Despite their conservatism, the CIU and the PNV have only made a half-hearted attempt to defend the principle of a zero deficit due to concerns that extreme adjustments aimed at restructuring the

country's national deficit could adversely affect the level of transfer payments made by the state to the autonomous regions or reduce large-scale investment by the state in their own region.

Employer's associations and trade unions have also expressed their opinions on the issue of stability policy. The two biggest trade unions are against measures designed to reduce the national deficit that fail to take into account the social implications of such a policy. The leader of the UGT (General Union of Workers) claimed that "Spanish society would not be able to cope with a reduction in the national deficit from 8.5% to 5.8%." Cándido Méndez said that reducing the deficit would make the economic crisis worse and would not only lead to more job losses, but also to deterioration in public services.[10] However, the head of the Workers' Commissions (*Comisiones Obreras* CC.OO), Ignacio Fernández Toxo, demanded that the President of the European Council, Herman Van Rompuy, "change a policy that focuses exclusively on reducing the deficit".[11]

Sandro Rosell, president of the Spanish Confederation of Employers' Organisations, CEOE, has described the government's target of reducing the national debt level to 5.8% in 2012 as "impossible" to achieve and also evaluates the target of 3% for 2013 as "barely achievable." He is not against reducing the country's debt in principle, but is afraid that the necessary changes to the economy could slow down public investment, especially in building and construction.[12]

For his part, the chairman of the Banco Santander, Emilio Botín, supports the government's economic policy measures, because they "guarantee budgetary stability" and defends a reduction in the deficit to 5.8% in 2012, as opposed to the 4.4% initially agreed with Brussels, as the latter would mean "strict adherence" to the stability pact.[13] Meanwhile, the chairman of the BBVA, Francisco González described the government's measures for rebalancing the national budget as "courageous"[14]. The president of the Foundation of Savings Banks (FUNCAS), Carlos Ocaña, claimed that the government's planned changes to corporation tax were "clearly not enough", and that "this cannot be the only consideration in reducing the national debt".[15]

POSITION OF THE SPANISH PARTIES				
POLITICAL PARTIES	**Mentioned in introduction to the party**	**Mentioned in party manifesto**	**In agree-ment with EU stability criteria**	**Own criteria**
PP	√	√	√	Categorically committed to achieving a zero deficit, regardless of the social consequences
PSOE	×	√	√	Moderate commitment to achieving a zero defi-cit, while taking potential social consequences into account
iu izquierda unida	×	√	×	A zero deficit is not a goal in itself
CiU	×	√	√	Stimulation of the eco-nomy and reduction in the size of central administration
EAJ PNV	×	√	√	No economic stability without budget stability

POSITION OF CIVIL SOCIETY ORGANISATIONS IN SPAIN				
Organisation	**Reducing the deficit is a priority**	**Support the govern-ment in reducing the country's national debt**	**Will Spain meet the targets set in the EU Stability and Growth?**	**Own criteria**
CC.OO	×	×	×	Reducing public debt will make the econo-mic crisis worse and put pressure on public services
UGT	×	×	×	The EU should be mo-re flexible in the crite-ria it sets for budget stability
CEOE	√	√	×	It will be difficult to achieve the goal of reducing public debt by tax reform alone
Santander	√	√	√	Overcoming the pre-sent crisis will require budget stability
BBVA	√	√	√	Measures aimed at reducing the budget deficit create a climate of confidence in the economy
FUNCAS	√	√	×	Spain needs to save 55 billion Euros in 2012

5. THE STABILITY PROGRAMME AND PUBLIC OPINION

Political and business organisations in Spain clearly believe that a policy of macro-economic stability is vital if the country is to survive the current economic crisis. However, it would appear that the majority of Spaniards do not support the measures aimed solely at reducing Spain's high levels of national debt. The Centre for Sociological Research (CIS) is the Span-ish organisation that offers the greatest insight into public opinion based on its polls and surveys.

Its most recent survey from February 2012[16] shows that the Spanish people consider the current economic situation to be "very bad" and in particular "worse than a year ago". Worst of all seems to be the fact that they have no real hope that the situation will get better within a year.

On the issue of the stability programme, the various sets of questions used in surveys conducted in December, August and July 2011 were repeated and from this we can draw the following conclusions:

- At times of economic crisis, the majority of the Spanish people would prefer "to invest in public services, even if it means that taxes have to go up", rather than "to reduce the deficit and public debt, although this can lead to higher unemployment".[17]

- On the issue of raising or lowering taxes, 41.35 % of Spaniards would be prepared to pay higher taxes if the money were used for social expenditure. In contrast, 35.95 % were in favour of lowering the tax burden, even if this resulted in a reduction in social expenditure.[18]

- When it comes to reducing the deficit, "reducing social expenditure (healthcare, education, etc.)" was rejected by the highest number of people (88.3%), followed by "raising taxes" (70.4%), "privatisation of certain public services (municipal cleaning, water supply, etc.)" (47.4 %) and "reducing public investment in infrastructure" (46.3%).[19]

The results of these surveys seem to reflect the latest trends in Spain. In regional elections in Andalusia and Asturias, polls in the run-up to the election were predicting a resounding success for the PP, and yet the party suffered a crushing defeat. Analysts agree that the Spanish public has lost confidence in the current ruling party because of the austerity measures adopted to reduce public debt, including reforms to labour laws, the mystery surrounding certain budget items that the government had inexplicably delayed announcing, and people's concerns over severe cuts and reductions in social services.[20]

These results were also reflected in the widespread support for the general strike called by the UGT and CCOO unions on 29 March 2012. According to the unions and the media, almost 80% of those in work heeded the call to strike.[21]

6. STRUCTURAL REFORMS TO IMPROVE COMPETITIVENESS

The Spanish economy is increasingly suffering from a lack of competitiveness. In an attempt to improve the situation, the former administration under Jose Luis Rodriguez Zapatero (PSOE) introduced a series of structural reforms. These included reforms to the pension system, and Law No. 27/2011 was enacted on 1 August 2011[22] to update, amend and modernise the country's social security system. The law had two main aims: firstly, raising the retirement age from 65 to 67, and secondly increasing the maximum period for pension contributions from 35 to 37 years. The calculation basis for pension entitlements was also increased by 10 years, from 15 to 25 years, and an incentive was introduced to encourage people to retire later in form of a 3.5% higher pension for every year that people delayed retirement. Businesses that take on young trainees now pay their social insurance contributions for up to two years. However, according to the CIS Opinion Barometer of March 2011, 80% of the Spanish people are against these reforms and do not agree with raising the retirement age.

Zapatero's government also introduced reforms to the financial sector with temporary measures aimed at avoiding a credit crunch, something which would have made stimulating the economy impossible. Between 2009 and 2011, this strategy was further enhanced by additional longer-term measures aimed at restructuring the credit services sector and improving the transparency of information provided by the banks. The creation of the Fund for Orderly Bank Restructuring (FROB), along with reforms to the savings bank law [23] were key factors in the process of integrating and restructuring the banks. In 2010, 12 different processes were recorded for the integration of savings banks, of which 9 were supported by funding from the FROB (€11.559 billion).

The new government formed by the PP introduced wage control measures in December in an attempt to improve Spain's competitiveness. Royal Decree Law 1888/2011 of 30 December 2011 froze the minimum wage for 2012. Reforms to the job market were also developed unilaterally by the government as they failed to garner the support of either the unions or the employers. Royal Decree Law No. 3/2012 of 10 February 2012 contained urgent measures to reform the labour market:

- Reduction of dismissal protection from 45 days to 33 days and 24 months' income.
- Permission to make staff redundant for business reasons in the event of losses in three consecutive quarters. Employees receive compensation payments equivalent to 20 days per year of employment.
- Lifting of the requirement for prior administrative authorisation in the event of mass layoffs.
- In accordance with Article 14, wage control measures make it possible for company managers to make substantial modifications to working conditions if they can demonstrate the existence of reasonable grounds by reason of competitiveness, productivity or technical or work organisation within the company. This means they can now make changes in the following areas: length of the working day, working hours, shift systems and rewards and remuneration.

The government's own assessment is that making the labour market more flexible should not have a direct effect on the employment situation and will not help to create jobs, even in the medium-term. It remains to be seen whether Spain's level of competitiveness will improve as a result.

1| *Although Spain's Economy Minister has indicated that in 2012 the level of national debt will be 79% of GDP. Cinco Días, 02.04.2012*
2| *El Mundo 31/10/2009. Also interesting is the article in the newspaper "20minutos" from 18.06.2008*
3| *The PP received 10,830,693 votes, 44.62% of all votes cast, which gave the party 186 seats in the Spanish parliament.*
4| *The PSOE received 6,973,880 votes, 28.73% of all votes cast, which gave the party 110 seats in parliament.*
5| *El Plural.com, 08.11.2011.*
6| *The United Left (IU) received 1,680,810 votes, 6.92% or all votes cast, which gave the party 11 seats in parliament.*
7| *Diario Público, 17.11.2011. Interview Cayo Lara.*
8| *The CiU received 1,014,263, 4.17% of all votes cast, which gave the party 16 seats in parliament.*
9| *The PNV received 323,517 votes, 1.33% of all votes cast, which gave the party 5 seats in parliament.*
10| *Diario Expansión, 05.03.2012. UGT, Cándido Méndez.*
11| *Agentur Europa Press, 01.3.2012. CCOO, Ignacio Fernández Toxo.*
12| *Agentur Europa Press, 05.03.2012.*
13| *Diario El Periódico, 30.03.2012.*

14| *Agentur Europa Press, 16.03.2012.*
15| *Agentur Europa Press, 26.03.2012.*
16| *Opinion Barometer from February 2012, questions 1, 2 and 3.*
17| *Question 13 of the Opinion Barometer from December 2011.*
18| *Question 12 of the Opinion Barometer from September 2011.*
19| *"Public opinion and economic policy", July 2011, CIS.*
20| *Prensa del día, 26 March 2011: Público, El País, El Mundo and ABC*
21| *CC.OO http://www.ccoo.es,*
La Vanguardia: http://www.lavanguardia.com/politica/20120329/54278996174/anplio-seguimiento-huelga-general-en-madrid.html
22| *Law No. 27/2011 on the updating, amending and modernising of the social security system.*
23| *Royal Decree-Law No. 11/2010 of 9 July 2010 on management bodies and other aspects of the legal system relating to savings banks.*

STABILITY CULTURE IN EUROPE: REPUBLIC OF IRELAND

BOOM, BUST, RECOVERY

Dieter W. Benecke

INTRODUCTION

Ireland looks back on an eventful history. In the 8th and 9th century, Continental Europe benefited from the advanced thinking of Irish monks on spiritual and religious matters. Between the 9th and 12th century, the wealth of Irish monasteries represented sufficient attraction for repeated raids by Vikings and Normans. In the 17th century, three kingdoms fought for dominance in Ireland, bringing the English to the scene. Oliver Cromwell emerged the victor, destroyed churches and monasteries and pushed Catholicism as well as Irish national culture underground.

Subsequently, the economy was controlled mainly by members of the English aristocracy, which resulted in broad swathes of the Irish population becoming impoverished, culminating in a great famine after failed harvests in the middle of the 19th century. This famine and massive emigration to the USA, Great Britain, Canada, Australia, New Zealand as well as Argentina reduced the existing population by almost a third. It was not until 1921 that the Irish obtained their independence as a separate state – at the price of the

secession of Northern Ireland, which, as everybody knows, was the cause of bloody unrest and campaigns of revenge until the 1990s.

This history up until the establishment of the Irish state – even far more turbulent in detail of course – and the values of Catholic social teaching had a strong influence on national culture in Ireland until the 1970s. From the eighties onwards, they were overlaid by neo-liberalism, and since the end of last century one can, with some reservations, speak of a "national culture" of pragmatism. The two historically leading parties, Fine Gael ("family or tribe of the Irish") and Fianna Fáil ("soldiers of destiny"), both essentially liberal-conservative, owe their existence to the fight against the British, and there are only minor differences in their ideologies. There has never been a strong social-democratic movement such as those in Scandinavia or Germany in Ireland because the political parties developed predominantly out of anti-British resistance movements and industry played a relatively minor role compared to agriculture up until the 1970s. The Labour Party has therefore always been in the shadow of the two major parties, but it has been able to exert some influence on the policies shaping the country as a coalition partner and has gained considerably in political power since the last elections in 2011.

1. THE ROAD TO BOOM TIMES

When Ireland joined the European Economic Community, the EEC, in 1973, it was the poorest country of the Community in terms of per capita income. It was not least thanks to subsidies it received from the EEC (structural funds, social funds, development funds, agricultural subsidies) that Ireland succeeded in narrowing the prosperity gap to other EEC countries. Decisive factors included the efforts of its own well-educated population, the virtually corruption-free prudent investment of the EEC aid and the fact that companies from the USA and other European states established operations in the country, attracted by the high levels of education and the relatively low wages until the eighties. For US companies in particular, the advantage of a shared language and the comparatively low levels of taxation acted as incentives to use Ireland as a "bridgehead" for the European domestic market.[1] In spite of a downturn in the early nineties, Ireland achieved the second highest per capita income in the European Union (EU) behind Luxembourg in 2007.

The former Fianna Fáil government, which was in charge for 15 years (until 2011), felt "closer to Boston than Berlin" (in the words of a minister), which was not only due to the partly massive direct investments by US companies (such as Dell, Microsoft and Pfizer) and the US sales market but also the neo-liberal orientation in political ideology.[2] In September 2008, directly following the Lehman- Brothers bank collapse, even the last remaining optimists could see that Ireland's new prosperity was largely built on sand. In order to prevent a Lehman-style catastrophe, the government decided to guarantee all bank deposits and bank loans "overnight", which triggered a chain reaction in the other European countries. There were several reasons for the banking crisis and the subsequent public finance and economic crisis in Ireland, which led to the incumbent government being voted out of office in February 2011:

- Loan interest rates were so low and loans were granted so readily by the banks that the population took on vast debts, not just for investments such as house purchases but also for "nouveau riche" consumer luxuries such as travel, large cars, holiday homes, etc. A fair number of people, and not just the rich by any means, flew to New York to do their Christmas shopping.[3]

- In line with bad neo-liberal practice, the banks were hardly regulated at all anymore. There is a rumour that the government had directed the regulating authority not to be too strict in exercising its supervision.[4] This allowed poorly secured, excessively high loans to be granted, which resulted in a high level of national debt because of the state bank guarantee.

- A tax arrangement allowed investments in the purchase of land and house building to be offset against tax. As construction prices increased by an average of 60 per cent between 2000 and 2007, it seemed a lucrative proposition to invest profits from other economic activities in the construction sector, thus reducing one's profit and income tax. Today, there are numerous houses and apartments standing empty in Ireland, which were intended to be sold one day, as the speculators thought until 2008. One hardly needs to add that the banks assisted the construction industry further with cheap loans and that some bankers were themselves involved in the construction sector speculation.

- As lending appeared to work so well in Ireland, the Irish banks went on to become involved in property funding in the USA and in the UK as well. The repercussions of the Lehman crisis therefore had double the impact on the Irish banks.

- There was a circle of "insiders", who steered each other towards business deals and juicy posts. This "Golden Circle"[5], made up of bankers, construction tycoons and financial speculators, maintained excellent links with the Fianna Fáil government. People met up to play golf – a national sport in Ireland –, never talking about business of course, according to subsequent statements by politicians. There have been no reports of any major corruption cases in the political arena or scandalous, lavish "parties for friends". But bankers and construction industry bosses did manage to quickly distribute assets to wives, children, nephews, etc. right before the crash, and it is highly unlikely that the then government had no idea, unless it was totally incompetent (which one should not surmise) as far as the economic development was concerned. This situation makes it very difficult for the present Fine Gael government, voted in in 2011, and the judiciary to retrieve the assets transferred to family members to help cover the debts.

- The tax policy also had an effect, albeit an indirect one. Although income tax is relatively high (top tax rate of 42 per cent with a low threshold), corporate tax is so low at 12.5 per cent that it presented an attraction not only to medium and long-term investors but also to speculators.[6]

Besides healthy growth in the production and service sectors, in export and in domestic demand, the road to boom times was thus determined to a considerable degree by speculation and the hope that the positive economic development would continue.[7] In many parts of the population, the deep-rooted Catholic (social) ethics were displaced through the economic upturn, partly aided, it has to be said, by a credibility problem affecting the Church, since more and more cases of sexual misconduct by priests and the way the authorities protected them came to public knowledge.

There has been a change in the national culture caused by the economic boom, which can be "felt" rather than proved. The hospitable and friendly nature of the people, formerly a "trademark" of Irish society and an attraction for German tourists since the publication of Heinrich Böll's travelogue the *Irish Journal*, have been overlaid increasingly by economic elements. Will these original elements of national culture make a comeback in the course of the recession, which has now been going on since 2008?

2. BUDGETARY AND FISCAL POLICIES

The "marketisation of national culture" is also evident in the concrete figures. Because of the step changes in development, it is of no great interest to look at figures from the distant past. The actual breakpoint is 2007. Up until that year, public finance policy was characterised by rises in expenditure. It did not follow the principle that one should set aside some reserves in good times for inevitable economic downturns in the future. And the national debt was merely around 25 per cent of gross domestic product (GDP) in the period from 2000 to 2007, i.e. far below the Maastricht ceiling of 60 per cent.

The situation changed dramatically in 2008, when the Fianna Fáil government took fright because of the Lehman bank collapse and guaranteed the deposits and loans of six Irish banks, actually acquiring stakes in the banks and fully nationalising one badly ailing bank (Anglo-Irish Bank, AIB). By the end of 2011, the national debt had increased to 107 per cent of GDP (€148 billion)[8]; the 2007 budget surplus of 0.2 per cent (it had been 3 per cent back in 2006) had changed into a deficit of 7.1 per cent of GDP in 2008 (then the highest in the EU) and increased further to 10.1 per cent of GDP in 2011. In May 2010, the European Central Bank (ECB) began to buy up Irish (and Portuguese) government bonds, which bore 5 per cent interest at that time. On the international capital market, interest rates rose to 14 per cent by July 2011.

People began to get the impression that the government would not be able to deal with the crisis successfully, particularly as the figures initially presented by the banks proved to have been greatly massaged. In view of this steadily deteriorating crisis, the increasing mistrust among the population and the pressures exerted by the media and the opposition, the government decided in November 2010 to seek help from the EU. As Portugal before it, Ireland found itself forced to agree to the "troika" (experts from the International Monetary Fund (IMF), the EU and the ECB) investigating and advising it. Undeterred by the grumblings of the

opposition and some media on account of the loss of sovereignty, the government accepted the EU bailout and was offered a loan facility of 85 billion Euros at 5.8 per cent interest[9]. The UK, which had itself received support through an IMF loan in 1976, granted Ireland additional borrowing facilities of approx. £7 billion[10], and Sweden, like the UK not a member of the eurozone, offered a further 500 million Euros.[11]

This enabled the Irish government to cover a large proportion of the banking debts and bank recapitalisation requirements so that it did not have to make drastic cuts to spending on pensions, health and education. In addition, the government set up the National Asset Management Agency (NAMA), which "bought" receivables to the value of 77 billion euros from the banks at a 30 to 50 per cent discount with the intention of imitating the action taken in Sweden and selling the distressed assets, such as properties, pieces of land, and company expansions, over the course of the next ten years to be able to return these funds to the taxpayer.

The Anglo-Irish Bank, which was hardest hit due to bank management scandals and careless lending, was wholly nationalised. A salary ceiling was imposed in the banks in which the government had taken a stake, similar to other European countries. Public sector salaries were cut by 20 per cent and shrinkage of the public sector was facilitated by offering incentives for early retirement. A markdown of private and government bonds ("hair cut") planned by the government similar to the one envisaged for Greece was rejected by the ECB.

Between 2008 and 2011, austerity measures and newly cautious lending practices resulted in the closure of numerous small businesses and in job losses, which pushed unemployment up to 14.7 per cent.[12] Unfortunately, the "German model" of securing jobs through short-time work was not followed, since the government of the time was not prepared (nor had the funds) to pay compensation for the pay reductions this would entail.

After the protest demonstrations in Greece, Italy and Spain, many European journalists expressed "surprise" about the fact that the austerity measures only prompted relatively minor protests among the Irish population. Rather than being due to a type of lethargy, this is actually due to the fact that

- people were aware that they had voted for the government that had led them into the crisis (four times!),
- people thought that living conditions during the boom period were relatively good compared to other European countries,
- memories about earlier worse times were still fresh,
- the social network (social security, unemployment benefit, family solidarity) is still intact,
- people are willing to give a new government a chance.

Of course there might still have been massive protests if the previous government had not stepped down. One could even say that to a certain extent the way the Irish population conducts itself is also a reflection of the national culture, maybe even a little "catholic": you have sinned, and now you have to do penance.

Once the EU bailout had been agreed, the government "capitulated" and called early elections, which turned into a disaster for the government parties Fianna Fáil and the Green Party[13] and gave a large majority to a new government coalition comprising Fine Gael and the Labour Party[14].

The new government, which came into office in March 2011, continued on the course that the "troika" had "imposed" on the previous government. It is, however, giving higher priority to measures to stimulate growth besides public sector cuts and the consolidation of the national budget. There are special loan programmes intended to provide support particularly to small and medium-sized companies, which had been suffering due to the drastic reductions in bank lending. Since exports are still strong – increasing by approx. 5.5 per cent in 2011 –, the economic system is still intact and competitive in spite of the closure of numerous SMEs and the decrease in domestic demand has been moderate, there is some cautious optimism that the crisis will be brought under control. While a programme to create 100,000 jobs initiated by the new government might sound rather overoptimistic, it does obligate the government to pay greater attention to the labour market[15] and provide incentives for greater investment by domestic and foreign companies.[16]

No doubt unemployment is currently the most serious problem inherited from the previous government. This problem is being "reduced artificially" through the emigration of some of Ireland's well-educated young people, acting as a "safety valve", such as Ireland has had to experience

in the past between the 1860s and the 1960s.[17] The loss of skilled workers of course also hampers the economic recovery.[18]

The repercussions of the national debt, which amounted to €148 billion in November 2011, were mitigated to some extent by the EU bailout. The current government is keeping to targets set by the "troika". As a result, confidence has risen once again in the financial markets.[19]

The government is planning the following measures to overcome the crisis:

- A budget adjustment in the amount of €3.8 billion;

- Expenditure consolidation of €2.2 billion, with current expenditure to be cut by 1.5 and capital expenditure by 0.7 billion Euros. Through these measures, the budget deficit has already gone down to 10.1 per cent of GDP ("troika" target: 10.6 per cent). According to the Ministry of Finance, the 2012 deficit will be €18.9 billion (2011: €21.4 billion) and is envisaged to fall to €7 billion by 2015, i.e. to 2.9 per cent of GDP. At that point, the 3 per cent value of the Maastricht/Lisbon Treaty would be reached.

- Additional revenues of €1.6 billion, including €1 billion from additional taxes; VAT has been increased from 21 to 23 per cent with effect from 1.1.2012 and a €100 property tax has been introduced; capital gains, energy and cigarette taxes have also been increased.

- Approx. €400 million of public sector cuts through a reduction in personnel by 6000 to 294,000;

- Measures to improve the labour market through loans for small and medium-sized companies[20], €17 billion funding measures and €550 million investments in R&D;

- Measures to expand trade with non-European countries.

Besides the "avaricious" conduct in the financial sector and neo-liberal policies, it was undoubtedly the government's decision to fully guarantee the bank deposits and loans that caused and subsequently disclosed Ireland's level of indebtedness and the resulting economic problems.

There is no point in speculating about what would have happened if the government of the day had not provided massive support to six banks. A more limited guarantee, for instance for deposits of up to €200,000, or maybe support for just one bank in conjunction with a limited guarantee for deposits at other banks would probably have made more economic sense. We don't know what went on behind closed doors in 2008. In hindsight, the state guarantee for the banks looks like a knee-jerk response to the Lehman collapse. One must not forget, though, that the new government has taken on a heavy burden and deserves European solidarity in its efforts to solve the financial problems – possibly in the form of improved bailout terms. This also appears to be indicated in view of the government's promising planning, which is illustrated by the following figures.

Economic development: forecast for 2011 to 2015 (percentage changes)

	2011	2012	2013	2014	2015
GDP growth*	1.0	1.3	2.4	3.0	3.0
Domestic demand	-2.5	-1.3	0.0	1.0	1.2
Government spending	-3.0	- 2.2	-2.2	-2.3	-2.1
Investment	-11.0	-1.0	3.2	4.6	4.8
Export	4.6	3.6	4.5	4.8	4.8
Import	1.6	1.6	2.8	3.4	3.8
Inflation	1.2	1.9	1.4	1.5	1.9
Employment	-1.9	0.2	0.8	1.2	1.6
Unemployment	14.	14.1	13.5	12.9	11.6

* According to these figures, gross domestic product is due to grow from €155 billion (2011) to €179 billion (2015), which would mean that with planned new borrowing of €7 billion the budget deficit would fall to 2.9 per cent.
Source: Department of Finance, Dublin forecast (Dec. 2011)

As the table shows, 2011 has been the first year of economic growth (1 per cent) since 2007. Judging by the structure of the economy and the working ethic of the Irish, the growth rates anticipated for the subsequent few years are by no means wishful thinking. Of course one must not forget that this relatively modest growth will not provide much scope for reducing the gap between high and low earners, which widened greatly during boom times, particularly if exports continue to be significantly more dynamic than domestic demand. This is why social policy will play an important role.

Whether it will be possible to stem the negative investment trend in the short term will depend very much on the action taken by the government and on whether an atmosphere of confidence can be created to attract foreign investment. The signs are currently looking positive. Rapid reductions in the unemployment figures, which are still expected to be high in 2015, will probably depend mainly on the success of the measures to encourage further vocational training and professional development.[21] The general education system also needs updating in line with the Finnish model if Ireland wants to remain competitive with its open economy.

If the growth forecasts come to be true, the following projected figures for the government's financial activities are realistic as well:

Financial governance, forecast 2011-2015

	2010	2010	2011	2012	2013	2014	2015
	billion Euros	per cent of GDP					
Income	53.9	34.6	34.9	34.5	34.7	34.8	34.6
Expenditure	102.8	65.9	44.9	43.1	42.2	39.8	37.5
Borrowing	48.8	31.3	10.1	8.6	7.5	5.0	2.9
Interest payments	4.9	3.1	3.3	4.2	5.6	5.8	5.7

Source: Department of Finance, Dublin (Dec. 2011)

This overview shows that the government is serious about wanting to consolidate public finances. It is one of the European governments that favour a fiscal compact in the EU – i.e. greater budgetary discipline and possible sanctions for deficit offenders – and is keen to try implementing it for Ireland.[22] No doubt there is still scope for reducing public spending further without cutting welfare benefits, although this would require a fundamental restructuring within government, Parliament and the Senate. Whether it will be possible to achieve the above-mentioned objectives will, of course, depend not just on the government, nor just on the Irish population. Based on a pessimistic assessment of the global economy, Ireland is unlikely to meet the Maastricht criteria by 2015. The probability of achieving the above-mentioned targets would be increased if the terms for the loan repayments were increased and if the interest rate for the bailout was reduced.

3. POLITICAL SYSTEM

The "pragmatic" national culture is currently determined strongly by the economic situation. The political system had a decisive influence on the political culture of the country until 2008 and will continue to do so for the foreseeable future.

Ireland is a parliamentary democracy with a directly elected parliament with a 5 year term (*Dáil*) and a senate (*Seanad*), whose membership comprises representatives from various institutions (e.g. universities, trades unions, the agricultural, industrial, cultural and education sectors, etc.). The directly elected President mainly performs representative duties and his or her signature is required for bills to pass into law. If the President has doubts about a bill being constitutional, he or she must consult with the Council of State and can then possibly refer it to the Supreme Court, as is the right of other institutions as well. If the government wishes to take measures affecting the constitution, a referendum is required (e.g. Lisbon Treaty, divorce, child protection).

It is the political parties that shape policies. Besides the historically largest parties, Fine Gael[23] and Fianna Fáil[24], and the Labour Party, Parliament currently comprises Deputies from the small Socialist Party[25] and from the nationalist Sinn Féin (14 MPs) as well as 15 independent Deputies. The Green Party, a coalition partner of the previous government, failed to gain any seats at the last parliamentary elections.

The 166 Deputies are directly elected, with multiple seats being contested under a preference system in the 43 constituencies. Voters can mark their preferences by assigning candidates priorities from 1 to 10 on the ballot paper. These priority ratings determine how the votes are split between the candidates, with between 20,000 and 30,000 votes required to win a seat depending on the size of the constituency population. This election system is geared strongly towards personalities and regional priorities. Party allegiance does play a part – and did more so than previously at the last parliamentary elections in 2011 as there was a desire to "punish" the old government party Fianna Fáil for its role in the debt fiasco –, but personalities are generally more important than the party, which also explains the high number of independent Deputies (15 out of 166). The Prime Minister (*Taoiseach*) is elected by Parliament.

The last parliamentary elections have caused a step change in the composition of Parliament and were untypical insofar as the Fianna Fáil party, which had determined government policy for the preceding 15 years, not only had to allow early elections to take place, but also lost two thirds of its seats in the 2011 elections. One could say that this election result also illustrates Ireland's national culture. It was not until the country threatened to descend into financial and economic chaos that the population finally woke up to the reality of its own responsibility, while it had previously put its trust into a party that had focused more on economic progress than on social justice for an astonishingly long time.

The current government is making great efforts to rebuild Ireland's reputation, engaging not only in intensive political contacts with its European partners and initiatives in the USA and China but also in new initiatives in Ireland itself.

Besides the debt problem, bringing down unemployment is high on the agenda. Under the new "Pathways to Work" scheme, assistance is offered to start-ups and job centres provide advice to jobseekers. In addition, the government subsidises newly created jobs for 18 months and requires the unemployed to undergo further education or training and to accept jobs that are below the pay scale of their previous occupation. These measures are specifically intended to enable the long-term unemployed (unemployed for over 21 months) to reintegrate into the labour force.[26] A new initiative by the name of "Change Nation" proposes to invite 50 leading social innovators and social entrepreneurs from different countries to a congress in Dublin with the purpose of receiving further impulses for innovation. Competitions for young inventors, which have also been held in the past, are being intensified. It is too early to foresee the possible impacts of these initiatives, but without them the chances of getting out of the mire would no doubt be slimmer. In simple terms, one could say: "Roll up your sleeves, tighten your belt and develop some initiatives". For an observer interested in the stability of the EU and of the euro, all this looks very positive compared to the "protest culture" in other highly indebted EU countries.

Of course not everybody supports these policies. Criticism emanates particularly from socially committed circles that justifiably demand greater equity, a goal that has been missing from the government programme to date. 25 to 30 per cent of the population are living on the poverty line in a country that is still wealthy in spite of the debt crisis. The most urgent problem besides unemployment and poverty is the welfare system, which has not been fulfilling the requirements of a modern and predominantly wealthy, but also aging society for years. The other point where criticism is justified concerns the government cuts in the education sector. And the political structures also require modernisation. For a long time here have been demands for the abolition of the Senate, whose members are not directly elected and which is increasingly considered a relic of the past. There are now also demands for Parliament to be slimmed down and for the ministries, whose professional competence is bolstered by personal advisers supporting ministers and the Prime Minister, to be modernised.[27]

The political structure is undoubtedly functional. The media are independent, and thanks to an Act of Freedom of Information they also engage in investigative activities. The trades unions are engaged intensively in discussions on social matters. Transparency and public discourse are therefore safeguarded.

One aspect that should not be underestimated in conjunction with Ireland's national culture and the solving of the current problems is culture in the narrow sense. Ireland has produced great literary figures, a long musical tradition and an interesting art scene. These cultural developments, which have probably not received adequate support from the government and the National Art Council, also represent a valuable asset to the country and its reputation in the international arena. Last but not least, the fact that the Irish are a very friendly people and that Ireland has a beautiful countryside and many tourist attractions benefit the country and its chances of recovery.

1| The beneficial tax regime probably also played an important part in the investment decisions of US companies. In the USA, the corporate tax rate is 35 per cent, in Ireland it is only 12.5 per cent (also to the chagrin of the Germans and the French). If the USA goes ahead and introduces taxation of profits made by US companies abroad, as announced by President Obama, Ireland's tax-based attraction for direct US investments will diminish.

2| In addition, there are influential interest groups comprised of US citizens of Irish extraction, for whom "nostalgic patriotism" does not end with participation in a St. Patrick's Day parade.

3| Factually totally correctly, but politically very ineptly, Prime Minister Enda Kenny stated at a symposium in Davos held this January that one of the reasons for the crisis had been that "people simply went mad borrowing".

4| It was thus possible for the manager of bank A to raise a loan from the bank that he or she managed, transfer this loan to bank B in November so that it would no longer appear it the bank's own balance sheet, and then take the loan back into "his" or "her" bank in January. The head of the financial regulator resigned in 2009.

5| In 2010, the think-tank TASC (Think-Tank for Action on Social Change) published a "map" of the economic and social relationships within the economic elite in Ireland ("Mapping the Golden Circle, Dublin 2010"). It illustrates how executives and members of supervisory boards "complemented'"each other. This is understandable in a relatively small country, but should make the supervisory authorities all the more vigilant.

6| This was probably one of the main reasons why the German Hypo Real Estate Holding AG founded the Deutsche Pfandbriefbank subsidiary DEPFA in Dublin, which contributed to a considerable extent to the losses suffered by Hypo Real Estate.

7| Members of the middle classes also took part in the speculation, as they believed that the price rises in the construction sector would continue and consequently invested their savings in property, but took on loans as well, which they are now having problems paying back (negative equity) since house and flat prices have dropped by some 60 per cent compared to 2007 and it is proving impossible to find tenants for many properties. Many young executives also bought properties that were far too large and too expensive on the assumption that they would easily be able to afford the mortgage payments as they progressed on the career ladder earning the partly extremely high salaries paid in this sector. Those who lost their jobs are now deeply in debt as even selling their property does not get them out of debt because of the erosion in value.

8| According to figures by the International Monetary Fund, quoted in the Irish Times of 6.8.2011, total debts in Ireland (incl. private debts) amount to €196 billion, i.e. €43,838 per person (Germany: €32,499), which does, however, represent only 2 per cent of the entire European debts (Italy for instance 23 per cent) and should therefore be manageable within the EU.

9| This relative high interest rate, which is still cheaper than that of the international capital market, has been a topic of negotiations between the Irish government and the EU ever since. Irelands wishes it to be reduced; the EU, and particularly Germany and France, demand reductions in Ireland's tax advantages in return.

10| This may also be due to the fact that Northern Ireland (as part of the UK) sends around two fifth of its exports to the Republic of Ireland. An even deeper economic crisis in Ireland would undoubtedly have curbed these imports from Northern Ireland and created problems with jobs there.

11| In the early 1990s, Sweden had got into financial trouble. The Swedish government had bought up bank debts in the hope of being able to sell them again later on, possibly at a profit. Iceland and Latvia had also received assistance from Sweden.

12| From 2000 to 2004, unemployment had dropped to 4.3 per cent and was thus at the lowest level in the EU, the same as in Luxembourg. By 2007, unemployment had risen to 5.5 per cent due to the downturn in the global economy. Collapses in the tourism and service sectors and the crisis in the USA caused unemployment to shoot up to 14.7 per cent in 2008/2009; since then it has only been brought down slightly to 14.3 per cent.

13| Fianna Fáil lost 57 of its 77 seats; the Green Party lost all its parliamentary seats.

14| Fine Gael won 77, the Labour Party 38 of 166 seats.

15| The unemployed are now obliged to take part in further education or training measures. If they don't comply, their unemployment benefit is cut.

16| The government has embarked on a course of intensive "economic diplomacy" in the countries of the EU, in the USA, India and China. Particular attention was paid to the visit by Chinese Vice President Xi Jinping in February, who chose Ireland as the only European country to visit on his return from visiting the USA.

17| It took the country's population until 2011 to rise back to the level of 4.5 million of 1861, and then only thanks to a birth rate that is high by European standards and the immigration of Eastern Europeans and Nigerians in the boom years.

18| There were similar developments during the Argentinian crisis of 2000/2001. The case of Argentina has been mentioned in Ireland frequently in efforts to justify the government's involvement with the banks. What people forgot in this context, however, was that Argentina had greater flexibility because of its ability to devalue its national currency.

19| This is reflected in lower interest rates for new or renewed government bonds. According to the Irish Times of 30.1.2012, two-year bonds were converted into three-year bonds on 26.1.2012, for which an interest rate of 5.2 per cent was payable. The government's aim is to pay no more than 4 per cent for two-year bonds and no more than 5 per cent where the term is 5 years.

20| In collaboration with the UK, the Netherlands, Sweden, Finland and Estonia, Ireland presented an initiative for stimulating growth in Europe via SMEs at the EU summit on 30.1.2012.

21| The existing system of vocational and professional training and education, which has been marred by scandals, is currently undergoing a revision. The results are not yet apparent.

22| There have only been positive statements on the Fiscal Compact coming from government quarters. In the opinion of the Attorney General, the Fiscal Compact would impact on the Lisbon Treaty and therefore on the Irish constitution. The government has therefore announced that it will hold a referendum on Ireland joining the Fiscal Compact. Although it is unlikely that the population will vote against these changes in a referendum – given the country's dependence on the EU and the European partners – one cannot exclude the possibility that voting behaviour in a referendum is often not just influenced by the actual referendum topic, but involves other political interests. In addition, not only the section of the population particularly affected by the financial crisis might vote against the Fiscal Compact but also nationalist elements, as happened with the referendum about the Lisbon Treaty. But this will not deter the government from pursuing the objectives of the Fiscal Compact.

23| *The MEPs from the Fine Gael party are members of the European People's Party grouping.*
24| *The Fianna Fáil MEPs have affiliated themselves with the European Liberal Democrats.*
25| *The Socialist Party, "to the left" of the Labour Party, has two seats in the current Parliament. The new People before Profit Alliance, which is similar in outlook, also has two seats.*
26| *The government aims at reducing long-term unemployment from 21 to 12 months.*
27| *By tradition, ministers obtain support from advisers. Although the new government has cut the previously extravagantly high salaries of these advisers, it is still spending approx. 3.2 million euros a year on them (see Irish Times, 28.1.2012).*

CULTURE OF STABILITY IN SWEDEN

Carl Johan Blydal

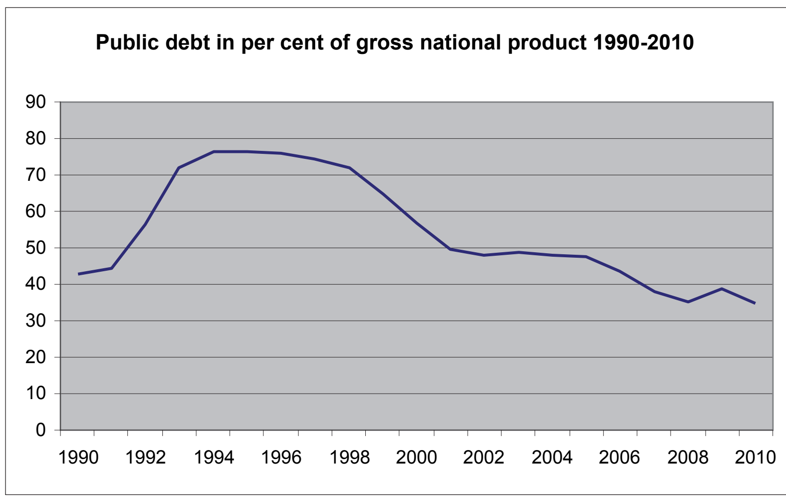
INTRODUCTION

In 2012, Sweden is considered one of the EU member states that have a model economy and healthy state finances. The central bank, *Riksbanken*, is independent, inflation is low, and the national budget fulfils the Maastricht criteria. Although Sweden did not negotiate exemptions as the UK and Denmark did when joining the EU, it has still not joined the Euro. However, there has been broad support in Parliament since 1997 for Sweden striving to satisfy the convergence criteria. When looking back over the last 20 years, i.e. the period between 1990, the approximate time the economic crisis started, and the present day, you can see that there has been a steady development in Swedish attitude towards a culture of stability, within the meaning of the term as it is understood in Germany. The topics covered in the following text include budgetary data, fiscal and monetary policies, the culture of stability in public opinion and in the party programmes as well as structural reforms.

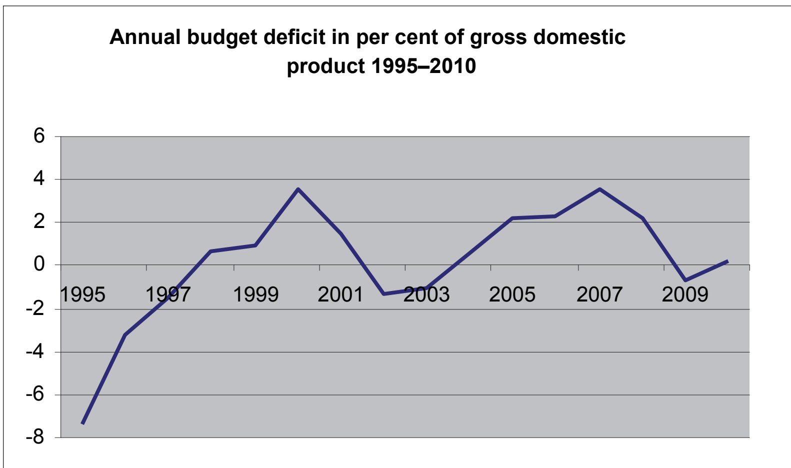
1. BUDGETARY DATA

Since the hard-hitting crisis of the early nineties, Swedish budgetary data have generally undergone a very positive development. In the statistics below, 1990 has been chosen as the starting point wherever possible in order to illustrate the extent of the changes.

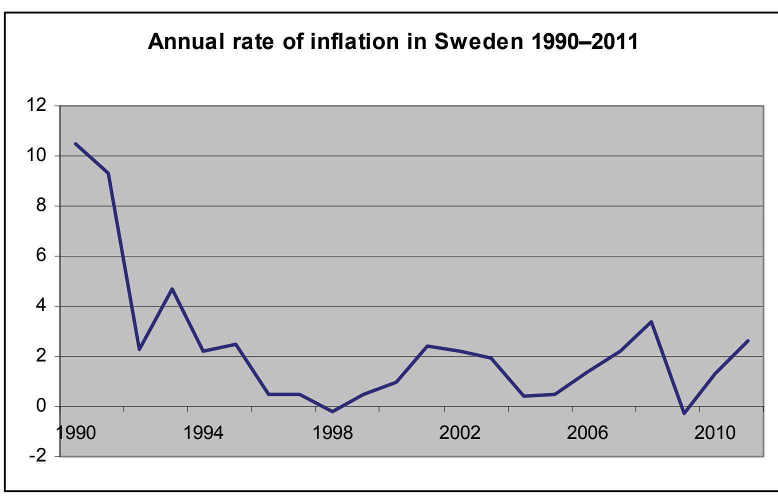
1.1 Debt Situation



1.2 New Borrowing



1.3 Rate of Inflation

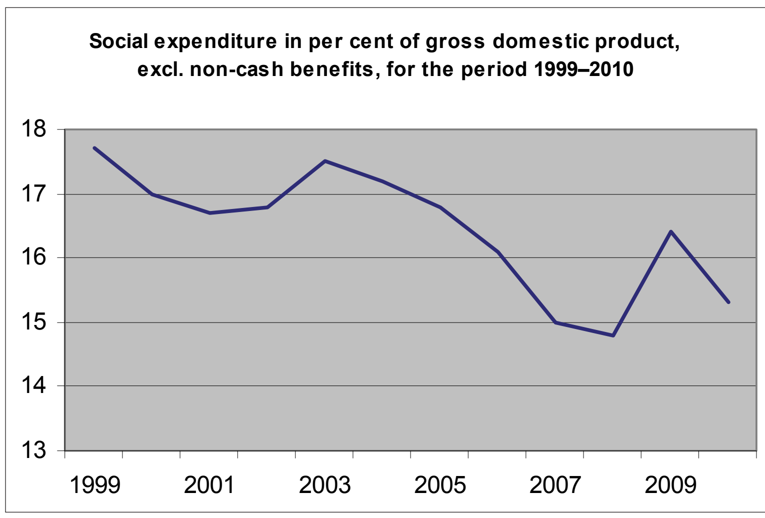


1.4 Ratio of Interest Payments to Tax Revenues

The ratio between interest payments and tax revenues (in million krona) in the period from 2000 to 2009.

Year	revenues	Interest	Percent
2000	1,166,533	92,575	7,94
2001	1,157,419	70,648	6,1
2002	1,159,324	78,113	6,74
2003	1,217,203	59,091	4,85
2004	1,281,421	50,562	3,95
2005	1,357,152	53,392	3,93
2006	1,426,000	52,975	3,71
2007	1,488,157	57,023	3,83
2008	1,497,557	54,499	3,64
2009	1,457,806	37,031	2,54

1.5 Social Expenditure Ratio

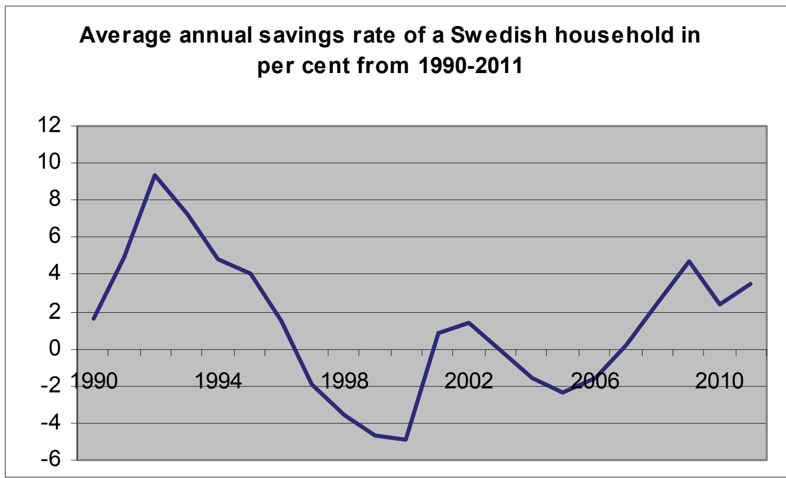


1.6 Black Economy and Corruption

According to estimates of the national financial authorities, which are based on figures from 1995 to 2003, the volume of undeclared earnings amounts to around five per cent of gross national product. Undeclared earnings represent around ten per cent of all earned income.[1] The financial authorities estimate that the black economy as a whole, which includes criminal activities such as the drugs trade and human trafficking besides illicit labour, amounts to 6.5 per cent of gross national product.[2] Tax evasion corresponds to around five per cent of gross national product.[3] In the international corruption index of the non-governmental Organisation Transparency International, Sweden was ranked 4th in 2011 with a score of 9.3 points out of 10 and thus one of the states least affected by corruption worldwide. By comparison, Germany was ranked 14th with a score of 8.0 points out of a maximum 10.[4]

1.7 Private Savings

The savings ratio is defined as the proportion of available household income put into savings in per cent.[5]



2. FISCAL POLICY

In the mid-eighties, Sweden started to deregulate its financial market and its national currency trade regulations in line with international developments. It was the Social Democrat Finance Minister Kjell-Olof Feldt who pushed the development forward. In conjunction with the worldwide recession of the eighties, deregulation of the financial market in Sweden resulted in a property and banking crisis that in turn weakened state finances as well as the currency. Feldt resigned during a government crisis in the recession year 1990. At the end of that year, the government decided to apply for EC membership. The reason for pursuing the application was not so much European conviction but rather a desire to benefit from the EC economically. After a change of government in 1991, it was up to the centre-right coalition government under Prime Minister Carl Bildt to deal with the economic crisis. In 1991, the Swedish krona was pegged to the European Currency Unit, the ECU, but when the Swedish krona was also affected by speculation during the Sterling crisis in 1992 and the central bank had increased the base rate to 500 per cent for a few days, the krona was allowed to float once again. The Bildt government further introduced measures to consolidate the national budget, some of which had painful impacts. When the centre-right coalition was replaced by a Social Democrat government in 1994, the new Finance Minister Göran Persson was eager to continue the consolidation course set by the previous government. Persson simul-

taneously cut social benefits and increased taxes, which, in connection with an upturn in business activities, helped to bolster Sweden's economic recovery.

To stabilise the state finances for the long term, the Social Democrat government took a bill on capping government spending, the "government expenditure ceiling" or *utgiftstaket*, through Parliament in 1995. The respective law came into force in 1996 and was amended in 2007. In addition to the expenditure ceiling, the government now announces the spending restrictions for the subsequent three years in each annual budget. This practice has been a statutory obligation since 2010.[6]

Since the forties at the latest, the Finance Minister has been playing a central role in Swedish parliamentary activities beside the head of government due to the budget coordination tasks assigned to the post. This was the case both under Social Democrat minority governments and centre-right coalition governments. During the period from 1955 to 1976, the Social Democrat Finance Minister Gunnar Sträng put his mark on financial policy under Prime Ministers Tage Erlander (1946–1968) and Olof Palme (1968–1976). The Social Democrat Göran Persson, who served as Prime Minister for many years (1996–2006), had also acquired a name for himself as an energetic man of action during his time as Finance Minister under Prime Minister Ingvar Carlsson (1994–1996). Finance Minister Anders Borg, who has been in office since 2006, has also joined the ranks of self-assured Swedish Finance Ministers.

The structure of the Swedish national budget essentially corresponds to that of the German one. It comprises 27 budget items.[7]

3. MONETARY POLICY

Sweden has not suffered the formative impact of serious inflation in the past as Germany did, although average annual inflation in the country was above 8 per cent between 1980 and 1990 and the krona was devalued against the dollar by 16 per cent in 1982. Instead, the individual factor that has had the greatest impact is the overall experience of the economic crisis in the early nineties. Dealing with this property, financial, banking and economic crisis and joining the EU in 1995 both helped to legitimise the policy of stability. Since 1993, the main aim of the Swedish central bank has been to prevent the annual inflation rate from exceeding two per cent. The central bank became independent in 1999. Its main task is to keep inflation low and stable. In addition, it is entrusted with safeguarding the stability of financial affairs.[8]

4. THE ROLE OF THE CULTURE OF STABILITY IN PARTY PROGRAMMES

There is no equivalent term in Swedish political discourse for "culture of stability" (original German term: "*Stabilitätskultur*"). Instead, people talk of stable state finances or use other paraphrases. For many political parties, the stability of state finances comes under the heading of taxes, which used to separate the conservative-liberal Moderate Party from nearly all other parties in Sweden for decades. In Sweden, high taxes are considered a prerequisite for the welfare state, which enjoys broad support among the population. It was not until the Moderate Party gave up its policy of tax reductions after its election defeat in 2002 that it was able to challenge the Social Democrats as leading party. In their public statements, Swedish parties give very different assessments of economic and financial policies. All four centre-right coalition parties stress the need for a responsible financial policy, for curbing expenditure and for stable state finances. The Moderate Party, for its part, views stability as a means to strengthen the economy, while the Centre Party justifies the policy of stability with the responsibility for the taxpayer's money. The Liberals and the Christian Democrats, on the other hand, describe the policy of stability as a prerequisite for the capability to continue funding the welfare state.[9] The opposition parties make no explicit mention of the subject of stable state finances when stating their positions. Social Democrats and members of the Left Party merely mention financial policy in connection with the necessity of not lowering taxes in order to retain the capability of funding the welfare state. By contrast, the Green Party actually mentions stable state finances as being of independent value aside from the objective of safeguarding the welfare state.[10] In addition to representatives from the parties on the left, the Swedish parliament also comprises members of the right-wing populist party of the Sweden Democrats. While the left-wing parties connect economic topics with the welfare state, the Sweden Democrats link them to the demand for national independence and a focus on Sweden's cultural character. But they also justify their opposition to the euro with the argument that the only reason that Sweden has healthy state finances is because it has not joined the European Currency Unit.[11]

5. THE ROLE OF THE CULTURE OF STABILITY IN PUBLIC OPINION

In the course of the last 20 years, discussions on the culture of stability in politics have focused on its purpose. The question of joining the euro zone is still a controversial one and the euro crisis makes it even harder for the euro advocates to find arguments in its favour. The clear results opposing the euro in the referendum held in 2003 is being put down to the split on this question among the political elites. The annual opinion polls of the University of Göteborg on the attitudes of the Swedish population on various political and social questions have not covered the policy of stability. The economic subject that is still occupying the public is the welfare state and its funding through taxes. The stability of the state finances and of the currency is not accorded any value in itself. When public discourse turns to the specific question of the stability of the Swedish state finances compared to other countries, the opinions generally bolster the established Swedish ideas of Sweden as a particularly exemplary country, which also naturally has particularly exemplary state finances.

6. STRUCTURAL REFORMS TO IMPROVE COMPETITIVENESS

Sweden is proud of its long tradition of responsible collaboration between the labour market parties, which was established in 1938. In the early seventies, the Trade Union Confederation and the Social Democratic Party managed to push through several settlements, which clearly favoured the trade unions in the eyes of the employers, and as a consequence the existing form of collaboration was terminated. From that time onwards, the Swedish labour market was strongly regulated, labour costs rose and wages were subject to strong marginal effects due to the high tax rates. However, during the nineties, various costs were reduced, including social insurance contributions paid by employers and business tax. In order to ensure that low wages would still produce a greater net income than benefits, the centre-right government under Prime Minister Fredrik Reinfeldt introduced a higher tax threshold with effect from 2006. Thanks to these reforms, Sweden is now generally in a good position.

All in all, it can therefore be said that Sweden has been successful in proceeding from a Keynesian-inspired policy, in which inflation was considered a means for full employment, to an anti-inflationary policy.

Since it is part of Swedish political culture not to look at other countries for role models – and if at all then only to Anglo-Saxon ones – you won't hear anyone say in Sweden that the country took its cue from the German *Bundesbank*. All the same, you no longer hear the type of criticism against an anti-inflationary policy imposed from outside that was still rife in the early nineties. There is widespread agreement across the political spectrum about the need for stable state finances, low new borrowing and low inflation to ensure Sweden's economic success. Sweden has thus joined the EU fiscal pact without intending to join the Euro in the foreseeable future.

1| Skatteverket: Svartköp och svartjobb i Sverige Del 1: Undersökningsresultat Rapport 2006:4, Stockholm 2006, S. 43, 45.
2| Skatteverket: Skatter i Sverige – Skattestatistisk årsbok 2011, Stockholm 2011, S. 227.
3| Skatteverket: Skatter i Sverige – Skattestatistisk årsbok 2011, Stockholm 2011, S. 229.
4| Transparency International Corruption Perception Index 2011.
5| Savings ratio: http://www.ekonomifakta.se/sv/Fakta/Ekonomi/Hushallens-ekonomi/ Hushallens-inkomster-konsumtion-och-sparande/ (04.03.2012).
6| Expenditure ceiling: http://www.ekonomifakta.se/sv/Fakta/Offentlig-ekonomi/Statsbudget/Statsbudgetens-ramverk/ (02.03.2012).
7| Structure of national budget: http://www.ekonomifakta.se/sv/Fakta/Offentlig-ekonomi/Statsbudget/ Statsbudgetens-utgifter/ (02.03.2012).
8| Remit of central bank: http://www.riksbank.se/sv/Riksbanken/Riksbankens-roll/ (04.03.2012).
9| Moderate Party: http://www.moderat.se/web/Ekonomi.aspx; Centre Party: http://www.centerpartiet.se/Centerpolitik/Politikomraden/Ekonomi-och-skatter/ Politik-A---O/Ekonomisk-politik/; Liberal Party: http://www.folkpartiet.se/Var-politik/Snabba-fakta/Ekonomi/; Christian Democrats: http://www.kristdemokraterna.se/ VarPolitik/Politikomraden/EkonomiOchSkatter (04.03.2012).
10| Social Democrats: http://www.socialdemokraterna.se/Var-politik/Var-politik-A-till-O/Skatter/; Left Party: http://www.vansterpartiet.se/index.php?option=com_content& view=article&id=2838&catid=486&Itemid=857; Green Party: http://www.mp.se/ templates/ mct_ 177. aspx? number=187831 (04.03.2012).
11| https://sverigedemokraterna.se/vara-asikter/var-politik-a-till-o/

CULTURE OF STABILITY IN THE EUROPEAN UNION

Stefan Gehrold | Joscha Ritz

INTRODUCTION

The eurozone crisis has revealed central weak points in European economic and financial policy: unsound budget policy and neglect of competitiveness in numerous member states of the European Union. In response to this, the EU has strengthened European economic management. The results of numerous difficult regulatory discussions in the European Parliament and between member states have been: strengthening of European incentives for credible budget policy and competitiveness. The new architecture of EU economic management has the potential to promote an economic policy in the member states that is aimed at macroeconomic stability. This is a necessary precondition for investment and consumption decisions, and thus essential for growth and employment in Europe.

1. BUDGET POLICY AND COMPETITIVENESS: DIVERGENCES BETWEEN THE MEMBER STATES

The economic-policy development of EU member states has diverged during the past decade. With the exception of Germany, northern European states exercised budgetary discipline up to the start of the economic and financial crisis

in 2008. Furthermore, they had begun a competitiveness drive (Germany only from 2005 onwards). The government debt in Finland, Denmark, Luxembourg, Sweden, the Netherlands and Ireland was pegged at a low level and continuously reduced. The inflation rate was in most cases significantly below the EU average, primarily in the UK, Finland, Sweden, Germany and Austria. According to the *Global Competitiveness Index* of the World Economic Forum, Sweden, Finland, the Netherlands and Denmark are regularly amongst the top ten most competitive states in the world.

In contrast to this, primarily in some southern and central European member states, the situation of public budgets deteriorated between 2000 and 2007, competitiveness was neglected. Hungary, Greece, Malta and Poland in particular continuously recorded deficits. Total indebtedness was high in 2011, primarily in Greece, Italy and Portugal. However, since 2002 Italy had been making significant efforts to rein in the debt burden. In Ireland, the debt burden rose from below 25% in the fourth quarter of 2007 to more than 100% of GDP in 2011 as a result of government measures to stabilise the banking system. Inflation rates that can be characterised as high in European comparison exist in Romania, Hungary, Bulgaria, the Slovak Republic and Latvia. Nevertheless, it is necessary to differentiate clearly. In some countries, national banks attempted to reduce indebtedness by increasing the inflation rates. In the Slovak Republic, for example, the elevated inflation was an expression and consequence of enormous growth rates.

With the exception of France, southern and central European states are regularly rated by the World Economic Forum as worse than northern European member states with regard to competitiveness: Greece, Romania, Bulgaria, the Slovak Republic and Latvia in particular are falling behind their EU partners.

Here too, it is also essential to differentiate: Some states such as Greece are unable to keep pace with economic development due to weak economic performance. Other states are starting from a much lower level, and are slowly closing the gap (e.g.: the Slovak Republic as well as Romania to a certain extent).

2. NEW EUROPEAN ARCHITECTURE FOR PROMOTING MACROECONOMIC STABILITY

The EU supports stable general economic conditions by means of incentives for budget consolidation and strengthening competitiveness. Sound budget policy by the member states is intended to be promoted in particular with the help of the Stability and Growth Pact. This prescribes a maximum new indebtedness of 3% of GDP, a maximum debt ratio of 60% of GDP (referred to as the Maastricht criteria) as well as a process in case of excessive new indebtedness. Main weak point: in the lead-up to the eurozone crisis, no sanctions were taken against countries with excessive deficits by the Council of Ministers in more than 60 cases, for political reasons. Particularly spectacular: the suspension of the deficit process against Germany and France due to political pressure exerted by the governments led by Gerhard Schröder and Jacques Chirac.

In response to the debt crisis, the EU then decided to reform the Pact in 2011. Key element: Incentives to sanction economically unsound member states were strengthened. If a member state contravenes the rules of the Pact, sanctions in future will be imposed quasi-automatically. In advance, however, the member states would have to agree by qualified majority whether a country with excessive deficits has implemented the recommended measures for correcting its budgetary problems within a period of grace. If the member states conclude that this has not been done, they decide to take sanctions with "qualified inverted majority". A decision is regarded as taken once the member states have not voted *against* with a qualified majority. Furthermore, in future sanctions are to be imposed earlier and more gradually. In addition, increased attention should be paid to the total government debt ratio (60% criterion). It remains to be seen whether the reform will lead to violations of the Maastricht criteria being punished more severely in future, and whether the pressure by the financial markets for budget consolidation will increase.

The European architecture for promoting sound budget policy is rounded off by the Fiscal Pact. This envisages the establishment of debt brakes in the member states – only the UK and the Czech Republic are not taking part. The structural deficit, i.e. the part of the deficit which is not due to cyclical fluctuations, is not allowed to exceed 0.5% of GDP. Only those member states with a debt ratio below 60% of GDP are allowed to run a

structural deficit of up to 1%. At present, this only applies to 5 signatory states (Estonia, Luxembourg, Finland, the Slovak Republic and Slovenia). Deviations are only allowed in case of unforeseen events that are outside the control of the member state, and in case of particularly poor economic development. If the debt brake is not complied with, a stabiliser will automatically be triggered, intended to return the member state to the path of a sound budget policy. The debt brake must be anchored in the constitutions of the signatory states, or on a comparable level. If necessary, the ECJ should be able to push through the prescribed implementation in national law. The task of bringing an action will fall to the three member states which jointly share the rotating Council Presidency. Countries with excessive deficits will in future cooperate with the Commission to work out an economic partnership programme, i.e. a plan for structural reforms. The partnership programme is monitored by the Commission and Council of Ministers. In future, this arrangement will restrict the economic and financial sovereignty of the member states in the event of unsound budget policy, and not just on imminent insolvency, but significantly earlier. As a result, existing national fiscal rules such as balanced-budget rules for a balanced budget balance, debt limits for limiting total indebtedness as well as expenditure rules for curtailing the expenditure trend are supplemented by an efficient instrument for promoting sustainable financial policy. The Fiscal Pact still has to prove itself in practice, however.

The competitiveness of European national economies should be strengthened particularly with the help of the European Reform Strategy2020. The successor strategy of the so-called Lisbon Strategy is intended to improve EU-wide coordination of structural reforms, thus laying the foundations for growth and employment in Europe. Against the backdrop of the economic and financial crisis, it is also important to pursue the objectives of stronger economic growth and consolidation of public finances in parallel in order to guarantee sustainable growth. Five core aims should be achieved by 2020:

- Employment rate of 75% amongst 20 to 64-year-olds
- Investments in research and development at 3% of GDP
- Reduction in greenhouse gas emissions by 20% compared to 1990 levels, increase in the proportion of renewable energies to 20% of total energy consumption, increase in energy efficiency by 20%

- Reduction in the proportion of early school leavers to maximum 10%, increase in the number of school leavers between 30 and 34 years who have achieved a university degree or corresponding qualification, to at least 40%
- Reduction in the number of people throughout Europe living in poverty or socially excluded, to max. 20 million.

The member states have translated these core aims into 27 national objectives in cooperation with the Commission. Ten integrated economic and labour market policy guidelines are decisive in terms of structural reforms at European and national level. The Commission has approved seven leading initiatives which define specific measures for implementing the strategy. The "Industrial policy in the age of globalisation" leading initiative envisages, for example, numerous measures to support the competitiveness and sustainability of European industry. The decisive factor for the success of Europe 2020 will be how the specifications are implemented at national level. The Commission has already warned: national targets are not ambitious enough, and the non-binding reform recommendations from the Commission are being ignored too frequently.

The following principle applies to all the assistance instruments that have been imposed by the Commission: the EU itself cannot decide anything. Implementation is in the hands of the member states.

The 17 Euro states as well as Poland, Denmark, Lithuania, Latvia, Bulgaria and Romania (17+) have agreed further reform steps as part of the Euro-Plus Pact. The UK, Sweden, the Czech Republic and Hungary did not sign the Pact. The objective is to strengthen competitiveness of the entire eurozone. It is a matter of preventing macroeconomic imbalances and reducing existing asymmetries. To this end, tried-and-tested policy approaches in the areas of economic, finance, labour market, pension and tax policy are to be exchanged and implemented flexibly in other states. The Pact only contains targets, indicators and reform options. It is left up to the member states to select the instruments. Once a year, heads of state and government of the 17+ conduct a check on the basis of a progress report by the Commission. Countries which need to make reforms are explicitly named ("blaming and shaming"), but are not sanctioned. The long-term objective is to approximate and harmonise national systems. It remains to be seen whether specific progress will be made in spite of the Pact's flexibility and extensive political monitoring. The results so far have been rather meagre.

A new process for correcting macroeconomic imbalances has been approved. It should be possible to take countermeasures at an early stage if competitiveness declines. The Commission monitors the competitiveness trend of the member states by means of indicators such as the development in unit labour costs. In February 2012, the Commission announced that twelve member states – including France and the UK – would be subjected to an in-depth analysis. The Commission and Council of Ministers will issue recommendations in the event of slippage. Alternately, financial sanctions can be imposed if these recommendations are repeatedly disregarded by Euro states.

3. THE EUROPEAN CENTRAL BANK: INDEPENDENT GUARANTOR OF PRICE STABILITY IN EUROPE?

The European Central Bank (ECB) is independent and obliged to maintain price stability. It sets incentives for stable general economic conditions in the member states. However, the ECB is only allowed to support the general economic policy of the EU to the extent that this does not call the goal of price stability into question. The independence of the ECB is anchored in the European treaties. The ECB is not allowed to make loans to national or EU institutions. Further instruments for strengthening the independence of the central bank: its sets its own budget, members of the Governing Council of the ECB have a long term of office and members of the Executive Board are not allowed to be reappointed.

The eurozone crisis is a test case for the independence of the ECB. Like no other European actor, the ECB has liquidity which is required in order to deal with the eurozone crisis. By purchasing government bonds from Euro states under financial pressure as well as increasing liquidity for commercial banks, the central bank has contributed to stabilising the eurozone crisis, at least in the short term. At the same time, the ECB has been repeatedly exposed to political pressure and criticism. Politicians of financially weak Euro states have demanded that the ECB should shoulder the costs of the eurozone crisis. German experts have criticised the ECB's involvement in the financial policy of member states, claiming that this waters down the incentives for sound economic and financial policy.

It is undisputed that the ECB under its new President, Mario Draghi, has developed into a central political actor in EU policy.

4. DIVERGING PERCEPTIONS OF AND APPROACHES TO DEALING WITH THE EUROZONE CRISIS IN THE EUROPEAN PARLIAMENT

The two largest European parties, the European People's Party (EPP) and the Socialists and Democrats (S&D) disagree with regard to budget consolidation and strengthening of competitiveness. The liberal-conservative EPP regards the crisis as a far-reaching crisis of confidence. It suggests the following mechanisms: creating stable general economic conditions through budget consolidation, fighting against inflation, avoiding a high tax burden as well as strengthening supervision and regulation of the financial sector. In contrast, the S&D explicitly does not regard the crisis as a debt crisis. In its eyes, the causes are an inadequately regulated financial sector, macroeconomic imbalances between the member states as well as a polarisation of income distribution. On-going efforts towards budget consolidation in the member states are, in the S&D's opinion, a threat to jobs and social cohesion. It suggests strengthening support for employment as part of the Stability and Growth Pact, taking account of labour and social-policy aspects in the budget consolidation, introducing Euro bonds as well as a budgetary income package – including the introduction of a tax on financial transactions.

Diverging perceptions of and approaches to resolving the crisis have led to difficult political debates in the European Parliament as well as between member states: these have focused on aspects such as the reform of the Stability and Growth Pact as well as the role of the competitive principle in correcting macroeconomic imbalances. By virtue of holding comfortable majorities in both chambers, the EPP has largely succeeded in anchoring incentives for sound budget policy and competitiveness in the new EU economic management.

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