SYNDICAT EUROPEÆN TRADE UNION CONFEDERATION

ETUC Position Paper: A European Treasury for Public Investment

Adopted at the ETUC Executive Committee on 15-16 March 2017

For many years now, the ETUC has been calling for public investment in Europe as the right trigger for a sound and sustainable recovery. At its 8-9 June 2016 Executive Committee, the ETUC reiterated its request for a revision of the Stability and Growth Pact with regard to its pro-cyclicality and impact on public investment. Henceforth, the European Commission considers that for 2017, a fiscal expansion of up to 0.5% of GDP is desirable across the euro area as a whole. However, this objective is not compatible with the current country-level policy decisions following Country-Specific Recommendations under the Stability and Growth Pact rules on public finances. The ETUC requests a steady level of public investment in every Member State. The following proposal for a European Treasury could be a way to insure a minimum level of public investment, in all Member States, ensuring a positive fiscal stance and limiting the widening of macroeconomic imbalances between Member States. With such a position, the ETUC expects to shape the future debates on the implementation of a fiscal capacity at the European level.

Introduction

The Five Presidents' report, "Completing Europe's Economic and Monetary Union", released in June 2015, calls for "fiscal stabilisation" tools, and suggests the setting up of a European Treasury.

The ETUC considers as positive the European institutions' recent efforts to stimulate growth and employment in Europe, especially through the launch of the Investment Plan for Europe (Juncker plan). However, total investment related to the European Fund for Strategic Investment (EFSI) is hardly reaching half of the annual investment the Commission considers necessary and is highly concentrated in some Member States. Some of those that suffered severe unemployment and chronic underinvestment have not benefited anywhere near as much as others from the Juncker Plan. Better complementarities between the different European schemes (EFSI and European funds) for economic development should be found, while a more balanced allocation of capital is vital under the Juncker plan.

Nonetheless, the ETUC is highly critical of strict respect for the rules embedded in the Stability and Growth Pact (SGP), even after endorsement by the Council, in February 2016, of the Commission's Communication, published on 13 January 2015, on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact". The ETUC believes that the flexibilities suggested by the European Commission, while softening austerity, are still inadequate considering the state of affairs in some Member States, and reiterates its call for a revision of the SGP, allowing counter-cyclical policies and economic recovery to take place[1].

The ETUC regrets that public investment has become one of the first targets for adjustment. We are demanding far greater public investment in infrastructure and research, as well as in universal and high-quality education, healthcare and social services. This is particularly relevant in economic downturns. We express strong

[1] *See ETUC position on the flexibilities within the Stability and Growth Pact, June 2016.*

reservations on public-private partnerships given problematic past experiences in a number of countries[2].

This position stems from the ETUC's analysis of the crisis as a consequence of financial deregulation which allowed balance of payment and banking crises and which ultimately resulted in a rise in public debt ratios. In this respect, the imposition of a one-size-fits-all policy, namely austerity policy, could not achieve the expected results. The policies implemented, through structural reforms of labour and product markets, had major negative social consequences and did not allow the economy to recover. Instead of finding a common way out of the crisis, beggar-thy-neighbour polices became a norm. Europe, therefore, is experiencing a significant rise in exports and records a current account surplus, due to a fall in internal demand and unconventional monetary policies. However, imbalances between Member States did not disappear.

The economic governance regime was unable to provide the guidance to counter the symmetric shock of the 2007-2008 crisis. Its reinforcement was unable to prevent or diminish the occurrence and the extent of imbalances. As a result, Europe is now trapped in a low-growth, low-employment, low-investment, low-inflation situation while monetary policy is supportive of economic recovery.

The ETUC believes that this state of affairs could be overcome by setting up a European Treasury in charge of raising funds to finance public investment and to allow the European economy to recover on a sustainable basis, in a world of global economic and political uncertainty.

The lack of public investment

There are two reasons why public investment is central for promoting economic growth. First, the private sector, which lacks confidence in the future, is still very risk-adverse and is failing to invest enough. The way to deal with this is for public authorities to show the way by kick-starting public investments. This will increase economic growth and create more confidence in the future, which will stimulate private investment. Secondly, public investment is needed to achieve long-term objectives[3], especially in a time of environmental crisis and digital transformation. Sufficient public investment guarantees that the next generation inherits an economic and infrastructural framework which allows further long-term sustainable growth.

The estimates of the hole in public and private investment in Europe in 2013 were between €230 billion and €370 billion. Public investment both in the Euro area and the European Union has been continuously decreasing since 2009. This leaves room for manoeuvre for additional investment. If funded by a European Treasury, this would allow Member States in difficult situations, especially in economic downturn, to avoid cutting public investment.

Many studies conducted by international economic institutions are now sensitive to and supportive on the issue. The IMF[4], the OECD[5] and the ECB[6] state that increased public

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2 See "Sound economic governance depends on strong civil service, IMF official says", in Public Finance International, 13 March 2017. See also http://www.tuac.org/fr/public/e-docs/00/00/0E/D7/document_doc.phtml

3 P. De Grauwe & J. Paulson (2016), "Monetary Policy and Public Investment", CEPS.

4 A. Abiad, D. Furceri & P. Topalova "Now Is a Good Time to Invest in Infrastructure", IMF direct, 2014.

5 OECD Economic outlook, June 2016.

6 Public investment in Europe, ECB Economic Bulletin, Issue 2/2016.

infrastructure investment, especially following an economic crisis, can be beneficial to the economy by raising output in the short term, by boosting demand, and by raising productive capacities in the long run. Positive effects can be increased through increased cooperation and continuing accommodative monetary policy. In addition, all the studies find positive effects on debt to GDP ratios.

However, the need to respect the principles embedded in the Stability and Growth Pact prevents Member States keeping their level of public investment, or even keeping positive net investment levels, implying a destruction of the public capital stock, while unused capacity in labour and capital is still significant. In addition, for those Member States that have achieved their fiscal goals and/or have more fiscal space to act, the tools of the European Semester can just recommend, not enforce more expansionary fiscal policies. In other words, the negative fiscal stance[7] implied by the policies implemented after 2010 had detrimental effects, did not prevent current account imbalance developments and therefore did not provide the ground for a strong and sustainable recovery[8].

A positive fiscal stance has just been recommended by the European Commission[9]. For 2017, a fiscal expansion of up to 0.5% of GDP is suggested. However, this objective is not compatible with current country-level policy decisions. Establishing a Treasury would make it possible to achieve such a positive fiscal stance.

Finally, as analysed by many studies, increasing public investment, while boosting recovery, would also enable Member States to diminish their public debt to GDP ratios.

A European Treasury

The Five Presidents' report requests such a stabilisation function to rest on the following guiding principles: It should not lead to permanent transfers between countries, nor should it undermine the incentives for sound fiscal policy-making at the national level.

The ETUC thinks that a Treasury with such features could be the right tool for future institutional and economic improvement while fixing some economic governance issues

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[7] *"While there is no universally accepted definition, the "fiscal stance" is usually understood as the orientation given to fiscal policy by governments' discretionary decisions on tax and expenditure. Traditionally, the fiscal stance is captured by the change in the structural primary balance (i.e. the budget balance corrected for the impact of the economic cycle, non-permanent measures and interest payments), although other indicators can also be used to characterise it (such as indicators based on expenditure growth net of new revenue measures). Depending on whether the government decides to support, reduce or leave unchanged the impact of public finances on the real economy – via the increase/reduction of spending, net of new tax measures – the fiscal stance is considered "expansionary", "contractionary" or "neutral", respectively." European Commission communication (2016), "Towards a positive fiscal stance for the euro area", COM(2016) 727 final.*

[8] *"As regards the application of the European fiscal rules under the Stability and Growth Pact, serious consideration should be given to revising the way in which public investment is taken into account, with a view to more favourable treatment of that expenditure. This could be done by replacing investment expenditure with the amortisation of public investments when determining the relevant budget balance. That would amount to adjusting the government's budget balance for net investments. This proposal would facilitate an investment boost, which is highly desirable in the current circumstances of low public investment, weak demand and low inflation, low potential growth and low interest rates." National Bank of Belgium (2016), Press release - Should public investment be boosted?; See also "ETUC position on the flexibilities within the Stability and Growth Pact".*

[9] *European Commission communication (2016), "Towards a positive fiscal stance for the euro area", COM(2016) 727 final.*

and boosting public investment, in line with the United Nations Sustainable Developments Goals.

The model proposed here closely follows J. Bibow's scheme for correcting a failed economic governance system[10]: the principle would be to create a Treasury[11] as a vehicle to pool future public investment spending in Europe and have it funded by proper European treasury securities. Member State governments would decide the total volume of public investment needed, for example 3% of the region's GDP, and its annual growth rate[12].

To ensure that no debt mutualisation would take place, each Member State would be endowed with a grant in proportion to its share of total GDP for investment purpose only. Each Member State is then free to choose in what sectors to invest. Interest payments made by Member States' National Treasuries would follow the same rule, ensuring a non-mutualisation of debts. Member States with sufficient fiscal space could still be in a position to increase further their level of public investment, however, at their own national rate of interest. In principle, Member States would see their tax contributions to finance the interest burden on the Treasury debt gradually build up over time as their debt service on national public debt is set to decline simultaneously. In other words, the Treasury would allow for a favourable effect on national primary budgets that should be stimulatory overall.

The Treasury would therefore stabilise public investment, the financial sector[13] while facilitating the work of national automatic stabilisers. The point being that attempting to unconditionally balance the budget and reduce national public debts to very low levels without establishing the crucial treasury-central bank axis and organising deficit spending at the centre is not a workable regime solution[14].

The European Treasury would allow and enable national treasuries to balance their structural current budgets.

Indeed, as a first step, the ETUC requested a revision of the Stability and Growth Pact with regard to its pro-cyclicality and impact on public investment. A European Treasury would also imply a revision of the Stability and Growth Pact and would ensure a minimum level of public investment in all Member States.

The concept covering current expenditure would need to be redefined within the proposed scheme as new public investment (excluding investment launched under national financing) and would now be covered by the Treasury. Member States would still be required to abide by all the rules of the Stability and Growth Pact, including recent

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[10] *J. Bibow (2013), "Lost at sea: The Euro Needs a Euro Treasury", LSE markets group special paper series, special paper n°227.*

[11] *A Treasury at the Euro area level would be the easiest and most straightforward way to go, while a Treasury at the EU level is surely conceivable. An opt in process could be envisaged for non-euro EU Member States.*

[12] *In accordance with the Maastricht criteria assumptions.*

[13] *Normalization of credit spreads and convergence of interest rates across the currency union will also beget important relief for private borrowers. With the Euro Treasury added to the euro regime, the term structure on Euro Treasury debt will become the common benchmark for financial instruments issued by debtors of euro member states irrespective of nationality*

[14] *"The current regime envisions member states running (near-) balanced public budgets forever, which would see public debt ratios decline towards (near) zero in the long run. This is a truly impossible endeavour;" in J. Bibow (2015), "Making the Euro Viable: the Euro Treasury Plan", Levy Economics Institute, Working paper n°842.*

flexibilities, but applied to current public expenditures only (and nationally funded public investment) as public capital expenditures would form a separate capital budget funded through common Treasury securities. The Treasury turns the "golden rule[15]" of sound public finances, implying that new public investment should be debt-financed, into the anchor of the European integration process. The Treasury would automatically withhold investment grants in case of non-compliance with the balanced (structural) budget rule as applied to current expenditures (and additional national capital expenditures) – and by the full amount of the target missed. Member States would thus have a very strong incentive not to miss out on the investment grant. Finally, the global volume of public investment could be revised upward in case of global recession giving extra margin of manoeuvre for automatic stabilisers to come into effect.

The European Stability Mechanism could be integrated in the Treasury as a real backstop to banking crises, and given its direct link with the ECB, could put an end to the "bank-sovereign doom-loop". The Treasury will be funded by a debt instrument designed to equal U.S. Treasury securities – a debt instrument the ECB can purchase for monetary policy and financial stability purposes.

In case of asymmetric shocks, by requiring and enabling the decline of national public debt ratios to very low levels in abidance with the rule of balancing structural current budgets at the national level, automatic stabilisers will have the necessary fiscal space to function freely. Indirectly then, the Treasury contributes to both area-wide and local stabilisation[16].

Conclusion

In the short term, the establishment of a Treasury would allow Member States to relaunch public investment on sustainable and steady bases.

Engaging public investment at the global level and removing public capital expenditure (financed by the Treasury) from public deficits would allow Member States to increase their fiscal space while respecting the rules of the SGP (revised to take account of current expenditure and national investment financing only). The required degree of further consolidation at the national level is therefore diminished.

In addition, transitioning from paying high interest on national debt to paying low interest on common debt results in significant overall budgetary relief. This benefit arises rapidly as soon as national debt ratios are seen to be set on favourable trajectories and credit ratings improve. In other words, the Treasury will create a beneficial impact on national primary budgets that should be stimulatory overall[17].

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15 See also footnote 7.

16 The Treasury could also be used as the conduit through which member states make or receive temporary fiscal transfers depending on their relative cyclical position vis-à-vis the regional average. Providing a liquidity pool for any temporary mismatches arising from automatic operation of a mutual insurance scheme based on a fixed rule can be most cheaply done through the Treasury issuing Treasury bills.

17 J. Biböw (2015), "Making the Euro Viable: the Euro Treasury Plan", Levy Economics Institute, Working paper.