OPINIONS

COMMITTEE OF THE REGIONS

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Opinion of the Committee of the Regions — Promoting quality of public spending in matters subject to EU action

(2015/C 019/02)

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Reference document	

I. **GENERAL COMMENTS**

THE COMMITTEE OF THE REGIONS,

1. stresses that the conditions for financing of the real economy are being fundamentally reshaped by the on-going financial, economic and social crisis. Against this backdrop, support for both public and private investment in the long term is becoming more and more essential. Indeed, public investment may be not only a stimulus for private investment but also a prerequisite, as it may be helpful in setting the appropriate structural conditions in which the economy is operating in a given region and may have a countercyclical effect in times of negative economic conditions. Beyond the complementarity with private investment, public investment may be useful in implementing objectives of general interest in areas (such as education, training, research, infrastructure, health, environment …) where public intervention is needed because the wider benefits to society are not matching private investment patterns;

2. notes that while worldwide direct investments are rising at an almost double-digit rate ([1]), private investment in the European Union is declining. At the same time, the currently extremely low real interest rates provide limited incentives for the private sector to support public investment in the short-term. It is therefore important to create favourable conditions that stimulate private investment, whilst at the same time increasing the level, quality and effectiveness of public investment, to compensate for the lack of private demand by public demand;

3. highlights that according to the IMF World Economic Outlook of October 2014 ([2]) 'for economies with clearly identified infrastructure needs and efficient public investment processes and where there is economic slack and monetary accommodation, there is a strong case for increasing public infrastructure investment';

4. highlights that within the European Union public investment declined by 20 % in real terms between 2008 and 2013. Recognises that underspending in public investment began prior to the crisis and worsened considerably since then. During the crisis, public investment was indeed further constrained by public intervention for the recapitalisation of banks, which had in particular to face the consequences of private over-investment in propertyin some eurozone countries. According to the latest Commission forecasts for 2013 and 2014, public investment in the EU-27 will reach historically low levels in 2014, having done so in respect of the private sector in 2013 ([3]);

([1]) See United Nations World Investment Report 2014, 24 June 2014, http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf
([2]) http://www.imf.org/external/pubs/ft/weo/2014/02/pdf/c3.pdf
([3]) See 6th Cohesion Report, p. 142.

5. supports therefore the growing consensus that it will prove impossible to restore sustained growth in the EU without stimulating growth-friendly investment ([4]). Stimulating growth-friendly investment is essential because it has the highest fiscal multiplier effect, i.e. induced impact on real GDP growth, in comparison with other types of expenditure such as government consumption, social transfers, VAT cuts or increased social contributions by employees ([5]);

6. points to the risk that a persistent low level of quality public investment would further deepen the dividing lines in terms of cohesion and convergence analysed in the European Commission 6th cohesion report;

7. draws attention, however, to the fact that both the high level of debt in certain Member States and the crisis-driven increase of expenditure on social services and transfers of capital to companies are reducing the 'fiscal room for manoeuvre' for public investment;

8. notes that the deterioration in public finances and the fiscal consolidation measures implemented since the end of 2010 have resulted in significant changes in the composition of public expenditure in a number of Member States. In particular, growth-friendly expenditure has been cut back disproportionately as part of fiscal consolidation measures and decreased in the EU-27 between 2008 and 2012 from 36,7 % to 35,6 % ([6]);

9. reiterates that sub-national governments play a key role with regard to public investment, as they carried out around 55 % of total public investment in the EU-28 in 2013. However, the share of sub-national government investment has declined from 2,2 % of EU-27 GDP in 1995 to 1,8 % in 2013, with a continuous fall in real terms since 2010 ([7]). This fall is also to a large extent due to a worsening of borrowing conditions. The introduction of rules governing sub-national authorities' borrowing or a tightening of those already in place as part of fiscal consolidation measures in many OECD countries is necessary in many cases in order to limit public debt but also leads to a further reduction of their capacity to invest;

10. underlines that Member States are responsible, according to Protocol 12 to the Treaty of the Functioning of the European Union (TFEU), for deficits of the general government, which includes all levels of government. At the same time, however, the effect of EU fiscal rules on European local and regional authorities differs widely. The impact depends on: i) how Member States have translated the EU fiscal rules into national legislation, ii) the level of fiscal decentralisation within a Member State, iii) the level of competences of local and regional authorities and iv) the financial situation of local and regional authorities which may vary significantly even within Member States;

11. stresses that while public investment is apprehended indirectly through the macroeconomic requirements set by the Stability and Growth Pact (SGP) to have the deficit and public debt below the thresholds of 3 % and 60 % of GDP respectively, the only specific reference to public investment contained in the EU Treaties appears in the context of the excessive deficit procedure (EDP), within which there is no differentiation of the different kind of expenditure. Indeed, Article 126(3) TFEU stipulates that the report preceding the launch of an EDP 'shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other 'relevant factors''. The list of the relevant factors in the regulation on the EDP includes 'developments in primary expenditure, both current and capital … the implementation of policies in the context of the common growth strategy of the Union, and the overall quality of public finances'.

([4]) For a definition of growth-friendly expenditure see European Commission, The Quality of Public Expenditure (2012).
([5]) See CEPII Policy Brief no 4, July 2014: A new Architecture for Public Investment in Europe by Natacha Valla, Thomas Brand and Sébastien Doisy, p. 4.
([6]) 6th Cohesion Report, p. 142.
([7]) 6th Cohesion Report, p. 144.

12. notes that no EU strategy on public investment has been conceived so far and that the European Commission has mostly limited itself to issuing non-binding recommendations to the Member States: 'Credible and growth-friendly consolidation that improves the efficiency of the tax structure as well as the quality of public spending will contribute to stimulating growth. (…) The Member States should strive in particular to maintain an adequate fiscal consolidation pace while preserving investments aimed at achieving the Europe 2020 goals for growth and jobs ([8])'. This recommendation was further specified in the 2013 Annual Growth Survey (AGS) which underlines that 'Investments in education, research, innovation and energy should be prioritised and strengthened where possible, while ensuring the efficiency of such expenditure (…)'; insists that any European strategy would have to comply strictly with the principle of subsidiarity;

13. welcomes, however, the fact that the 2014 Country-Specific Recommendations (CSRs) put a stronger emphasis on long-term measures to boost growth and recognise that short-term fiscal consolidation measures should be accompanied, in a rebalanced policy-mix, by long-term investments for growth and jobs. The CSRs refer frequently to research and innovation, knowledge, education, market access for SMEs (13 countries), the energy sector (12 countries) and transport and broadband infrastructure (8 countries) ([9]);

14. recalls that the 'Compact for Growth and Jobs' adopted by the Heads of State or Government on 28—29 June 2012 stated that 'particular attention must be given to investment into future-oriented areas directly related to the economy's growth potential and ensuring the sustainability of pension systems. The Commission is monitoring the impact of tight budget constraints on growth enhancing public expenditure and on public investment. It will report on the quality of public spending and the scope for possible action within the boundaries of the EU and national fiscal frameworks'. To this mandate, the European Commission replied by presenting a rather academic contribution, which neither had a proper legal status nor contained any kind of policy recommendations ([10]);

15. is of the view that the recommendation included in the European Council conclusions from December 2012 to '(exploit) the possibilities offered by the EU's existing fiscal framework to balance productive public investment needs with fiscal discipline objectives (…) in the preventive arm of the SGP ([11])' have not been followed up but remain highly topical as underlined by the President of the ECB on 22 August 2014 when he stated: 'since 2010 the euro area has suffered from fiscal policy being less available and effective, especially compared with other large advanced economies […] it would be helpful for the overall stance of policy if fiscal policy could play a greater role alongside monetary policy, and I believe there is scope for this, while taking into account our specific initial conditions and legal constraints';

16. recalls that the SGP allows for flexibility in its application in exceptional and temporary circumstances, which have been defined by Regulation (EC) No 1177/2011, and that according to the Commission's own evaluation, 'the EU fiscal framework offers enough scope to balance the acknowledgment of productive public investment needs with fiscal discipline objectives' ([12]).

II. **POLICY RECOMMENDATIONS**

17. Referring to the conclusions of the European Council of 27 June 2014, which confirmed that '… the Union needs bold steps to foster growth, increase investments, create more and better jobs and encourage reforms for competitiveness' and that 'this also requires making best use of the flexibility that is built into the existing Stability and Growth Pact rules', asks the Commission to publish a communication on how it intends to apply the existing flexibility provisions of the SGP in order to promote the public investments needed to boost economic growth;

18. recalls that, in order to provide an adequate and sustainable level of net public investment, it is important to prevent governments — when fulfilling fiscal adjustment requirements — from cutting investment spending. In fact, experience shows that at the height of the crisis governments decided to cut investment rather than current spending. It is well-known, however, that investment is crucial to driving effective structural action by Europe's regions and cities, as beneficiaries of the ESI Funds; without that stimulus, it would not be possible to ensure that they play an active participatory role in the Europe 2020 strategy;

([8]) Commission Communication on "A Blueprint for a deep and genuine EMU — launching an European debate" COM(2012) 0777 final, 30.11.2012, point 3.1.6.
([9]) See: CoR analysis of the Country-Specific Recommendations for 2014, July 2014.
([10]) http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp125_en.pdf
([11]) Conclusions of the European Council of 14 December 2012 on Completing EMU, point 2.
([12]) EC, Quality of public expenditure, p. 31.

19. reiterates its support for the European Parliament's call to exclude national co-financing of investments co-financed by the European Union under partnership agreements and, in that context, asks that investment made by local and regional authorities in the context of the Structural Funds and the Cohesion Fund be excluded from the rules of the Stability and Growth Pact; but also points out that that all levels of government must strive to limit their levels of public debt in order to lower the burden of repayment for future generations;

20. expresses concern over the fact that the new Eurostat accountancy norm ESA 2010, to be implemented as of September 2014, does not distinguish between expenditure and investment. Moreover, in certain Member States, the transposition in national law of these norms translates into local and regional authorities being obliged to apply maximum investment ceilings per year and per inhabitant. These ceilings hinder in particular local and regional authorities in certain Member States from providing the co-financing needed for ESIF projects. These ceilings also block those LRAs which have financial means in reserve to launch significant investment projects not related to ESIF. Urges therefore the European Commission to present a report on the implementation of ESA 2010;

21. stresses that excluding the co-financing from deficit calculations would be of particular importance in order to speed up and facilitate the process of implementing European programmes. Stresses, in addition, that this exclusion would also be important for those Member States that have been most affected by the crisis and have received financial support under a programme from the Balance of Payments Mechanism for countries not in the Euro area (Romania, Latvia and Hungary) or from the European Financial Stabilisation Mechanism for countries in the Euro area (Greece, Ireland and Portugal) and where the national co-financing rate for structural funds has been lowered since 2011. Excluding the co-financing rate from deficit calculations would, moreover, facilitate access to and greater co-financing for local and regional authorities, which in turn would allow EU funds to be spread to cover more projects and thus increase their leverage effect and promote quality public investment;

22. considering that EU public investment through the cohesion policy is already determined by considerations about the differentiated quality of public investment through the principle of thematic concentration (EU 2020 earmarking/menu setting), asks the European Commission why the EU should not consider applying similar assessment criteria to the consideration of national public spending;

23. calls on the European Commission to present a White Paper setting out an EU-level typology for quality of public investment in the accounts of public expenditure according to its long-term effects. Eventually, such a typology could lead to a weighted consideration of the quality of public investment in the calculation of budget deficits and/or to a better consideration of the actual macroeconomic cycle/context with the ultimate objective of introducing a 'golden rule' allowing for a separation in public accountancy between current spending and investment so as to avoid public investments with long-term net benefits being accounted for their short-term negative 'costs' only;

24. also confirms its support for the recommendations made in November 2012 by the European Parliament in its report on a 'Social Investment Pact — as a response to the crisis' ([13]). Recognising the long-lasting effects of the current economic and financial crisis i.e. on the quantity and quality of social investments in Europe, the report called for a renewed approach to Social Investments in Europe. Indeed, the European Parliament suggested that, based on the model of the 'Euro Plus Pact', Member States should consider signing a 'Social Investment Pact', setting investment targets to meet the objectives of the Europe 2020 Strategy related to employment, social policy and education. The Committee therefore calls in addition for the public investment strategy to be oriented towards environmental and social objectives;

25. calls for a review of the methodology for calculating the 'structural deficit' in order to take account of the intrinsic characteristics of national economies and of the structural differences of public expenditure ([14]);

26. requests the European Commission to include a chapter on the quality of public investment, including at subnational level, in every annual report on Economic and Monetary Union (EMU) public finances;

([13]) http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2012-0419+0+DOC+XML+V0//EN&language=EN

([14]) For an explanation of why public expenditure differs from one country to another see Céline Mareuge/Catherine Merckling: 'Pourquoi les dépenses publiques sont-elles plus élevées dans certains pays'?, Note d'Analyse France Stratégie, Juillet 2014.

27. draws attention to the fact that the quality of spending is determined to a large extent by good governance. In this regard, shares the view that 'spending reviews appear as an adequate instrument of expenditure performance. They consist in seeking a "smarter" expenditure allocation across national policy priorities based on a selective and sustainable expenditure-based consolidation; i.e., an in-depth and coordinated examination of baseline expenditure in light of the policy outcomes pursued. They offer in principle a more sustainable approach compared to linear across-the-board expenditure cuts which may generate some negative economic and social impact in the medium and long term' ([15]);

28. suggests that the European Commission officially endorses the Organisation for Economic Cooperation and Development (OECD) recommendation establishing a set of principles for public investment ([16]) (March 2014). Welcomes the fact that throughout the areas of policy action (coordination of public investment, capacity-building, setting of framework conditions), the recommendation recognises the important and growing role of regional and local authorities in planning and implementing public investment;

29. welcomes the announcement of the 'Juncker package', which should mobilise up to EUR 300 billion in total for investment in sectors such as broadband, energy and infrastructure in industrial areas and in the field of communications; and asks in this connection for more information on the origin of resources, their true additionality and the amount of private resources intended to be activated, calling for local and regional authorities to be properly involved in the process of planning and implementing the support measures;

30. proposes in the framework of the mid-term review of the Europe 2020 Strategy that an indicator relating to the investment rate be included in the macroeconomic scoreboard;

31. insists that a European Strategy to step up the fight against tax evasion and curb tax avoidance would at the same time free revenues to relaunch quality public investments and guarantee a better and fairer level playing field in terms of corporate competition;

32. suggests that the establishment of a European savings account could contribute to the financing of the EUR 300 billion investment package.

33. expects that the revenues of the Financial Transaction Tax which 11 Member States intend to establish on the basis of a reinforced cooperation would be coordinated with the EUR 300 billion investment package;

34. pleads for a stronger coordination between the EIB and the national investment banks with a possible pooling of financial capacity around shared projects in order to create cross-border spill over effects;

35. welcomes the first European project bond for superfast broadband launched by the European Commission and the European Investment Bank (EIB) on 23 July 2014 and calls for the launching of further cross-border/European project bonds to support infrastructure development;

36. supports a further increase in the paid-in capital of the EIB by EUR 10 billion, on the model of the successful increase of mid-2012 which allowed the lending to SMEs to almost double. A further increase of another EUR 10 billion would allow another increase of up to EUR 80 billion in EIB lending, insofar as it falls within the EIB's mandate in the individual Member States.

37. In this context, asks the European Commission to examine the possibility that a small part of the EU budget, possibly around EUR 5 billion annually, be used as a risk buffer to allow the EIB to lend additional resources for financing infrastructure projects (project bonds) and to promote innovation, which could generate up to EUR 40 billion of investment;

Brussels, 3 December 2014.

The President
of the Committee of the Regions

Michel LEBRUN

([15]) See European Commission Economic Paper 525: Public Spending Reviews: design, conduct and implementation, Summary for non-specialists, July 2014.

([16]) http://www.oecd.org/gov/regional-policy/oecd-principles-on-effective-public-investment.htm