A FRESH LOOK AT THE FISCAL FRAMEWORK IN THE EU

Andreas Theophanous
Professor of Political Economy, President of the Center for European and International Affairs of the University of Nicosia

The overriding concern in the EU today – one that is shared globally as shown by the G8 summit – is the specific fiscal policy that is being followed in relation to the broader crisis in a number of Eurozone countries. The current policy approach is intensely disputed by different philosophical streams and schools of thought.

There are times when strict adherence to specific fiscal indicators creates more problems than it solves. By definition, fiscal consolidation and the rationalisation of the revenue and expenditure sides of a state budget must be a sine-qua-non in any country. At the same time however, we should not disregard the significance of other relevant factors.

The Greek people today are suffering not only as a result of a corrupt socio-economic and political system but also as a result of one-sided policy prescriptions imposed by the European Union in the last two years. In this regard there appears to be an unprecedented adherence to the philosophy of draconian fiscal discipline without any effort to promote growth policies. When an economy is in recession and it has to suffer through additional taxation and expenditure cuts, economic activity is crippled, the standard of living drops and fiscal indicators deteriorate. Furthermore, when an economy is in crisis, a sustained policy of fiscal austerity leads to misery. Improved fiscal indicators can only emerge from a growth policy combined with a particular long-term and persistent policy of fiscal consolidation and rationalisation of revenues and expenditures.

The EU must re-examine policy priorities and the results of the philosophy followed so far in relation to the Eurozone which has often run against the provisions of a fiscal union. It is a dangerous misconception to believe that the cost of a presumed exit of Greece from the Eurozone would be minimal. In this regard one cannot rule out that other countries may also leave the Eurozone if their economic conditions further deteriorate.

The debt crisis and the overall economic crisis raise several issues including fiscal consolidation within and solidarity among the member states. But above all the EU may have to revisit some fundamental economic principles. Containing budget deficits and encouraging rationalization of public spending is in principle correct. But trying to maintain balanced budgets annually irrespective of the economic circumstances of a country would, most likely, create more problems that it could solve. Indeed during a recession such an approach is procyclical;

in other words, it will worsen the recession. At times it may turn into a depression. The case of Greece may be indicative.

In Cyprus too, when the number of registered unemployed has approached 40.000, instead of following a growth oriented policy direction, the overriding objective appears to be locked on a tight fiscal policy. Instead of setting as primary objective the recovery of the economy and the reduction of unemployment, the focus remains on reducing the fiscal deficit to 2,5% of GDP in 2012. At this juncture, priority should be placed on growth. Additional budgetary spending cuts must be the result of measures aimed at fiscal consolidation and rationalisation, and the removal of distortions. Such measures would have to be implemented even if the fiscal balance had been in surplus. It is possible that there will be additional taxation measures. It should be stressed that such a policy will create more problems than it will solve.

The assumption of the EU Presidency by the Republic of Cyprus in the second half of 2012 provides an excellent opportunity for the government to submit an alternative proposal in relation to the ongoing economic crisis. In short, and given the overriding concern regarding fiscal policy at the Pan-European level, it is important to put forth our own proposal for fiscal balance over a longer protracted period of time instead of annually balanced budgets. It may be recalled that in the first post World War II years this was similar to the formal fiscal policy of Sweden (in this case the average over time was 0%) and it appeared in the literature as the Swedish Budget.

Such a context, would, for example, allow states to aim for a balanced budget on the basis of the average over an extended period of time (such as five years for instance). This would permit a discretionary expansionary fiscal policy in times of recession or crisis. This specific approach encourages a growth orientation. The specific details of this approach must be further explored by the appropriate policy units to be submitted to our European partners for discussion.