



Public Services contribution to smart, sustainable and inclusive growth

Financing Services of General Interest: Challenges

Client: CEEP

Rotterdam, June 6, 2011

The aim of this fact sheet is to provide participants in the conference the 16-17 June with information to grasp the complexity of the various selected topics. As a second step, this document highlights some links with current EU policies and suggest points for debates.

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Executive summary

This fact sheet presents the short- and long-term challenges faced by Member States (MS) in the European Union (EU) with respect to financing Services of General Interest (SGIs). SGI providers directly contribute more than 26 per cent to the EU GDP and employ approximately 30 per cent of people in the EU. In this context, SGIs play an important role in the debate on how to enhance growth in the post-crisis times while at the same time having a strategic aim of making growth sustainable, smart and inclusive, as set by Europe 2020 strategy. In broad terms, the challenge is to combine the widely-promoted fiscal consolidation strategies with growth enhancing strategies, both of which should take into account SGIs as an important component of European economies.

The obvious current challenge is to address the recent economic and financial crisis aftermath and its negative effects on public finances across MS. Governments responded to the crisis with discretionary stimulus packages and automatic stabilizers, which has resulted in high public debt levels. In the longer-term, we increasingly face challenges such as ageing population and ensuring quality and accessibility of provision of SGIs in the era of globalisation and technological advancements. Globalisation to some extent limits options for increasing taxation as a revenue source mainly through increased capital mobility and global tax competition. On the other hand, higher-value added activities tend to be located in countries with best infrastructures and human capital, which calls for increased attention for SGIs.

There is a clear need to cater for new methods of financing or delivering public infrastructures and SGIs. Also, there is growing pressure, particularly from local and regional administrations, to facilitate contracting authorities in procurement transactions by providing more flexibility in procedures, speeding up contract awards, and reducing the risk of legal challenges afterwards. Involvement of private players in this respect seems to be becoming increasingly common and public procurement is one of the tools of this cooperation between public authorities and private entities.

Points for discussion and debate

- There is a growing demand for SGIs due to our ageing population and way of living (cf. climate change). Do governments/public authorities have enough financial resources to meet the present (and growing) demand for SGIs?
- What policies would you suggest at European/national level to foster investments in key activities?
- How did your enterprise / organisation adapt to financial challenges?
- Should the focus be on ensuring quality and accessibility of services across the society, or should it be limited to certain target groups?

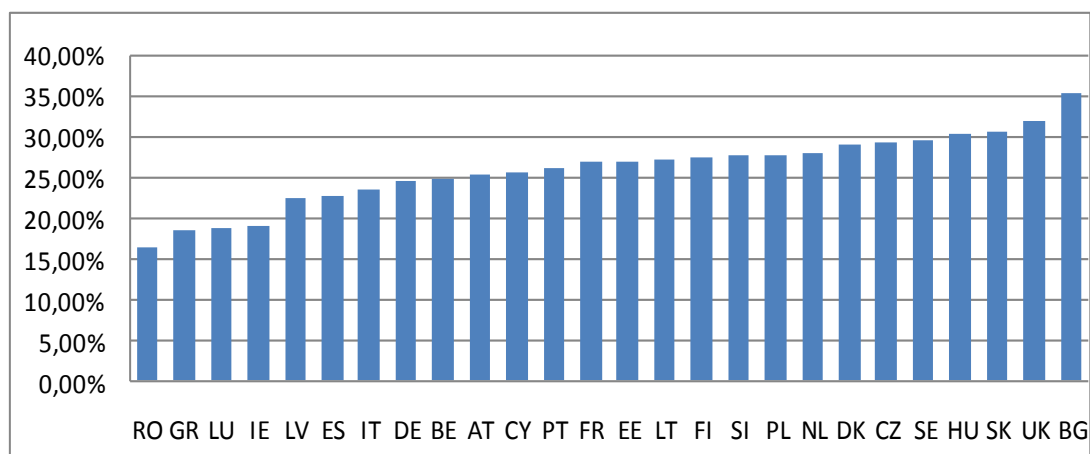
1 Introduction

This fact sheet aims to present short- and long-term challenges faced by Member States (MS) of the European Union (EU) with respect to financing Services of General Interest (SGIs)¹.

One of the major current political economy debates that has become increasingly important concerns the level of financing public services. The debate has a strong ideological background. Related to that the size of the welfare state, or more narrowly, the practices of financing SGIs in different countries have historical, sociological and political reasons.

Countries can be classified according to different criteria. If we look at data from the Mapping project², we can see the various sizes of Public Services in different countries, **Erreur ! Source du renvoi introuvable.** depicts public services contribution to GDP, while Figure 2 shows public services contribution to employment across MS. On average, public service providers directly contribute more than 26 per cent to the EU GDP and employ approximately 30 per cent of people in the EU.

Figure 1: Public Services contribution to GDP by country

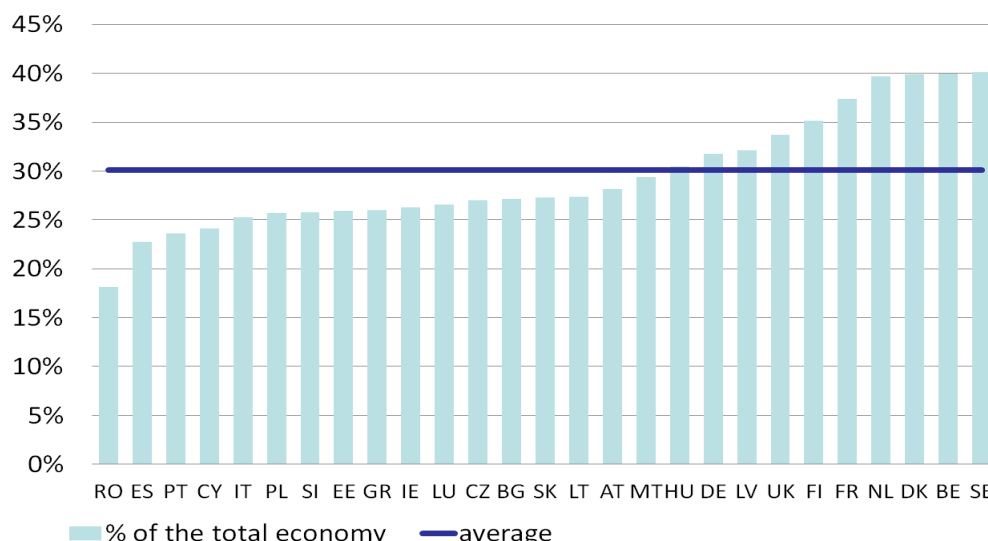


Source: "Public Services in the European Union & in the 27 Member States: statistics, organisation and regulations", RAP – Europa ong, "Mapping of the Public Services" Project commissioned by CEEP, May 2010

¹ According to the EC Communication (COM(2007)725) Services of general interest cover a broad range of activities, from the large network industries such as energy, telecommunications, transport, audiovisual broadcasting and postal services to education, water supply, waste management, health and social services. Although their scope and organisation vary significantly according to histories and cultures of state intervention, they can be defined as the services, both economic and non-economic, which the public authorities classify as being of general interest and subject to specific public service obligations.

² "Public Services in the European Union & in the 27 Member States: statistics, organisation and regulations", RAP – Europa ong, "Mapping of the Public Services" Project commissioned by CEEP, May 2010

Figure 2: Public Services contribution to employment by country



Source: “Public Services in the European Union & in the 27 Member States: statistics, organisation and regulations”, RAP – Europa ong, “Mapping of the Public Services” Project commissioned by CEEP, May 2010

Looking at the importance of government expenditure, for example, total public spending as a share of GDP (see Table 1), gives an idea about the levels of public spending to which citizens of different MS are used to benefit from. For example, in the case of Spain, general government expenditure as a share of GDP has been relatively low due to less developed social services relative to some other MS, lower defence expenditure as well as limited administrative costs compared to neighbouring MS.³

Table 1: Total general government expenditure as % of GDP (2004-2007 average)

Low (40% and below)		Medium (41-49%)		High (50% and above)	
Luxembourg	39.7	Belgium	49.7	Sweden	53.0
Spain	38.7	Finland	49.1	France	52.9
Bulgaria	38.1	Italy	48.1	Denmark	52.5
Slovakia	36.7	Germany	45.7	Austria	50.8
Latvia	36.4	Netherlands	45.4	Hungary	50.2
Romania	34.8	Greece	45.3		
Ireland	34.7	Portugal	44.9		
Switzerland	34.3	Slovenia	44.6		
Estonia	33.9	Malta	44.3		
Lithuania	33.8	Czech Rep.	44.1		
		UK	43.8		
		Poland	43.0		
		Iceland	42.6		
		Norway	42.3		
		Cyprus	42.2		

Source: Eurostat

In the countries of EU a social market economy model has been developed, which means, for financing of public services, we have to think about long term needs of essential infrastructures and welfare state arrangements which are in-line with our social development goals while ensuring

³ Based on interview with CEEP official.

functioning markets so that the economies of the MS as well as the EU Single Market remain flexible and competitive. There is no “one-size-fits-all” approach as countries are free to choose their approach within that social market economy model. Whatever the approach might be the country’s welfare state arrangements should follow a sustainable pattern and help promote the strategic goals set by the Europe 2020 agenda. For example, a recent Communication from the European Commission (EC)⁴ on the suggested actions to promote the Single Market reminds of the importance of social and territorial cohesion for European integration and the fact that market forces alone cannot adequately respond to all collective needs. Keeping in mind the strategic context set by the Europe 2020 agenda, the communication recognises Services of General Economic Interest (SGEIs) as “essential building blocks of the European social model that is both highly competitive and socially inclusive”.

Box 1: Financing of Services of General Interest (SGIs) in compliance with EU rules

The recent guide of the EC⁵ provides guidance to the MS on how they may finance SGIs, and in particular Social Services of General Interest (SSGIs), in compliance with EU rules. Most important rules are rules on state aid, public procurement and internal market. According to the guide: “MS have a wide margin of discretion when it comes to organising and financing their SGEIs. Public authorities can allocate a subsidy or a tax benefit, but they can also award an exclusive or special right to the service provider in order to ensure that the SGEI is provided, as long as this right does not go beyond what is necessary to allow the SGEI to be performed under economically acceptable conditions.”

1.1 Short and long-term challenges in financing SGIs

The debate on the level and methods of financing SGIs is closely linked to short and long-term challenges of public finance but also short and long term political and economic objectives. On the one hand, we have just experienced a severe economic crisis, the aftermath of which is still to be fully seen. Most importantly, it is not yet clear if the crisis had a permanent or just a temporary effect on potential economic growth of our economies.

The current economic environment presents a serious problem – governments simply do not have enough financial resources to meet the present (and growing) demand for SGIs. MS in the EU have less money available for funding investment expenditure. On the other hand, we increasingly face longer-term challenges such as ageing population, as well need to account for other issues, such as ensuring quality and accessibility of provision of SGIs in the era of globalisation and technological advancements. These issues raise a clear need to see how Europe is going to respond to such challenges with our policies regarding financing of SGIs. We need to understand how sustainable are our current financial arrangements and what solutions are needed to make them both sustainable and in-line with our strategic goals (contributing to sustainable, smart and inclusive growth as championed by the Europe 2020 Strategy).

1.1.1 Current fiscal pressures – crisis aftermath – national perspectives

The recent global financial and economic crisis has highlighted these short- and long-term challenges, especially in the EU. Figure 3 below compares general government deficit/surplus

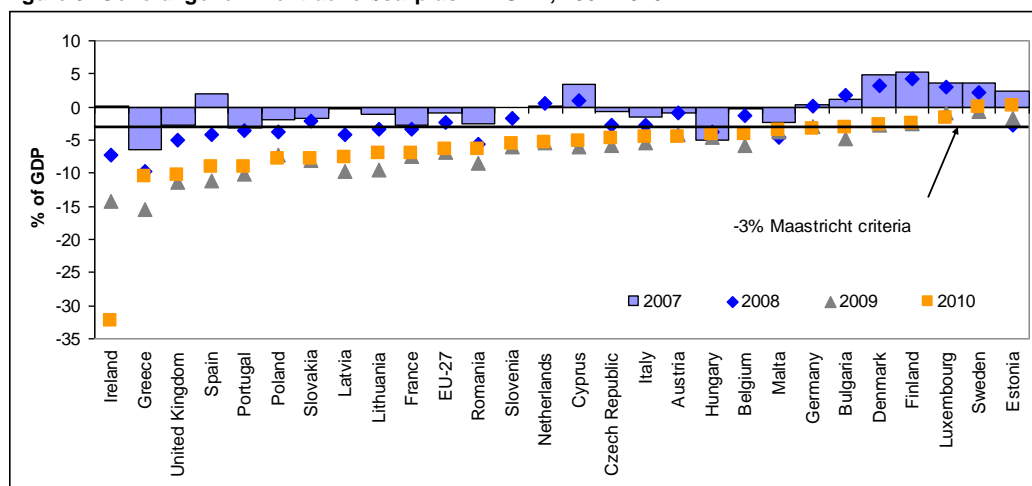
⁴ European Commission (2011), “Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions – Single Market Act”, COM (2011) 206 Final.

⁵ European Commission (2010), European Commission Staff Working Document of 7th December, 2010, “Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest” (SEC(2010) 1545 final). Available at <http://ec.europa.eu/social/main.jsp?langId=lt&catId=89&newsId=977&furtherNews=yes> .

across the EU-27 countries for 2007-2010. Figure 4 does the same for general government gross consolidated debt. The data for these years were taken to show the effects of the recent global economic crisis⁶.

We observe that prior to the crisis three EU MS (Greece, Hungary and Portugal) ran budget deficits exceeding the official Maastricht criteria limiting the budget deficit to 3 per cent of GDP. Greece had a large budget deficit totalling 6.4 per cent of GDP. The majority of other MS stayed below the limit by having low budget deficits. Eleven countries managed to have budget surpluses of various degrees. Finland and Denmark had relatively large surpluses of around 5 per cent of GDP.

Figure 3: General government deficit/surplus in EU-27, 2007-2010



Source: Eurostat

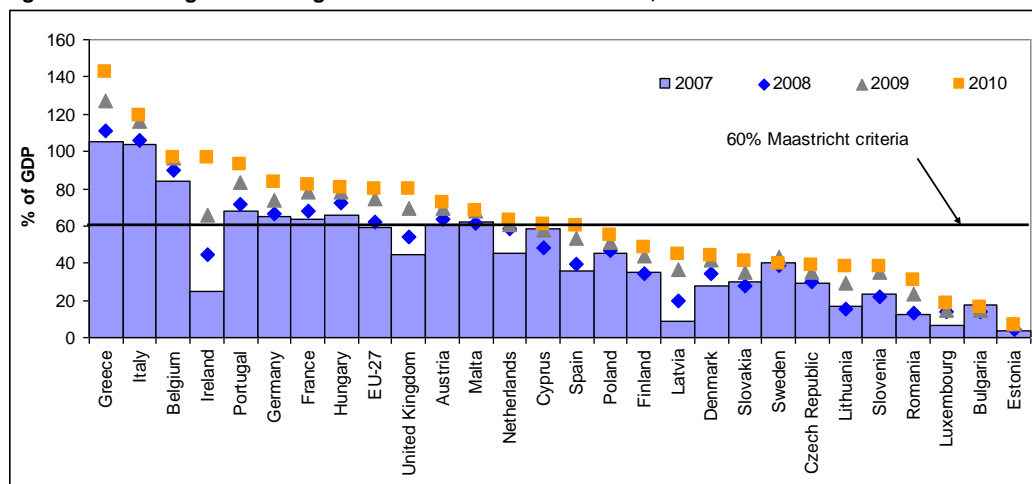
The budgetary difficulties, which governments faced due to the crisis, concerned both reduced revenues as well as increased expenses. Reduced revenues were mainly due to lower tax income as a consequence of a decline in economic activity. Governments responded to the crisis with discretionary stimulus packages and automatic stabilizers, which led to soaring budget deficits. This can be seen by looking at the figures of budget deficits for 2008-2010 in Figure 3. Only a few countries managed to attain an approximately budget neutral result in 2010, whereas the majority of countries run deficits of various degree. To some extent, countries, which managed to stay below or a little above the Maastricht deficit criterion, were the countries that were better prepared for crisis (i.e. had surpluses in 2007). The best performers in 2010 were Estonia, Sweden, Luxembourg, Finland and Denmark. The UK and Greece had a budget deficit of over 10 per cent of GDP, whereas Ireland topped the list with a budget deficit of 32.4 per cent of GDP as a consequence of its banking sector rescue plan. On the other hand, we have to remember that crisis severity and timing differed across countries when comparing the extent and timing of the budgetary consequences.

To different extents, deficits had to be financed by increased borrowing, which resulted in excessive public debt levels (see Figure 4). Already in 2007 a number of countries had gross public debts rather close to or above the official Maastricht debt criterion of 60 per cent of GDP. With a few exceptions, such as the Nordic countries, these were the old MS. Much of this is because they have longer history of public spending and deficit financing. Italy and Greece topped the list with highest debts of more than 100 per cent of GDP.

⁶ 2007 can be used as a base year for comparison, because the crisis effects spread to Europe largely starting 2008.

Looking at the public debt figures of 2010, we see the consequences of the crisis: most countries increased their debt levels. Ireland did so by over 70 percentage points of GDP, followed by Greece, Latvia and the United Kingdom (over 35 percentage points of GDP each). Several countries managed to increase gross debt levels by a few percentage points of GDP or even slightly reduce the gross debt. Overall, Estonia showed special fiscal discipline. Its public debt was only 6.6 per cent of GDP in 2010 making a stronger case for the introduction of Euro it was aiming for and which took place in the beginning of 2011.

Figure 4: General government gross consolidated debt in EU-27, 2007-2010



Source: Eurostat

A recent paper by the European Investment Bank - EIB (2010)⁷ assesses the impact of the crisis on financing of infrastructure in the EU. Since the beginning of the crisis public financing of infrastructure increased from 3 percent in the old MS in 2007 to 8 percent. In contrast, private finance fell by 4 percent in 2008 and another 13 percent in 2009. In total, private finance fell by more than 15 percent since the beginning of the recent crisis. There are no important differences between the old MS and the new MS in this respect.

Important country differences were identified between individual countries. For example, in the UK government finance in infrastructure went up by a cumulative 25 percent from 2007 to 2009 whereas in Lithuania, it went down by 16 percent over the same period. In all countries except Finland, the Czech Republic and Cyprus, private investment was lower than before the recent crisis, but the degree to which private finance has shrunk varied considerably. No major differences were observed across sectors (education, health, transport and utilities) as private investment volumes fell in all sectors.

When concerned with strategic goals, we have to increasingly look at the longer-term challenges for public finance. Among these,, we increasingly face longer-term challenges such as ageing population , as well need to account for other issues, such as ensuring quality and accessibility of provision of SGIs in the era of globalisation and technological advancements

⁷ EIB (2010), "Public and private financing of infrastructure", EIB Papers, Volume 15, No1

1.2 Long term challenges on financing of Public Services

1.2.2 Ageing population

On top of possible adverse effects of the recent crisis on the potential long-term growth of our economies, Europe is facing ageing population. Ageing population will further decrease the potential growth through shrinking working populations, and therefore we should increasingly count on productivity as a source of growth. The ageing population trend is said to challenge public finance resources through increased needs of spending on pensions, healthcare and long-term (elderly) care while ensuring financing needs to a proportionally lower population. On the other hand, needs for expenditure on education and unemployment benefits will likely decrease.

Box 2: Age related expenditure in EU MS

According to the 2009 Ageing Report⁸, “on the basis of current policies, age-related public expenditure is projected to increase on average by about 4 ¾ percentage points of GDP by 2060 in the EU – and by more than 5 percentage points in the euro area. Most of the projected increase in public spending over the period 2007-2060 will be on pensions (+2.4 p.p. of GDP), health care (+1.5 p.p. of GDP) and long-term care (+1.1 p.p. of GDP). Potential offsetting savings in public spending on education and unemployment benefits are likely to be very limited (-0.2 p.p. of GDP for each item).” Accounting for these, the total costs of ageing till 2035 are estimated to increase by 2.7 percentage points of GDP (using 2007 as the base year). Across Europe, ageing costs are estimated to reach on average 2.7 percentage points of GDP, while particularly high levels in Luxembourg and Greece (over 9 percentage points of GDP), and Slovenia (close to 7 percentage points of GDP) till 2035. Poland is the only country where age-related spending is estimated to decline rather than increase, saving 2.7 percentage points of GDP till 2035 largely owing to implementation of substantial pension reforms.

Globalisation

Globalisation can be analysed from various perspectives, however one of the most relevant aspects of it challenging public finances is capital mobility. While greater capital mobility has its benefits, it also limits the options of (tax) revenue increases for governments. Tax levels are one of the factors which companies consider when choosing their locations, which puts pressure on governments not to increase tax burdens. On the other hand, tax levels are not the most important factor. Especially companies of higher added-value activities might rather decide on their locations based on levels of infrastructure and human capital, which calls for increased attention to SGIs.

Technological advancements⁹

Technological advancements are being witnessed in this age of globalisation. Such advancements in the form of innovations often involve high risk and fulfil long term objectives, which can make it unattractive for financial service providers to supply loans to finance the innovation. Also, sufficient money may be unavailable to the service providers to fund the implementation of the innovation activity. Where private sector involvement is insufficient, governments and administrations could play a role in mitigating such barriers to innovation by, for example, subsidising the innovation or grant tax credits.

⁸ European Commission (DG ECFIN) and the Economic Policy Committee (AWG) (2009) “[The 2009 Ageing Report : Economic and budgetary projections for the EU-27 MS \(2008-2060\)](http://europa.eu/epc/pdf/technical_press_briefing_ageing_report.pdf)” and the technical press briefing of the report available at http://europa.eu/epc/pdf/technical_press_briefing_ageing_report.pdf

⁹ Based on interview with CEEP official.

1.2.3 Quality and accessibility of SGIs¹⁰

SGIs have become ever more necessary to meet the increasing needs of citizens in order to promote both economic efficiency and social justice. There is a growing concern on the provision of these services as well as on their quality and accessibility. The scale of capital investments required in areas such as transport, healthcare, energy and telecommunication have increased manifold implying that reliance on public sources of revenue may be insufficient to meet future needs. Capital investments put an additional strain on domestic public finances, especially in those economies that have sought to comply with the requirements of fiscal discipline in joining the single currency. New MS can gain access to EU structural funds only if matching finance is made available from national sources.

1.3 Towards fiscal consolidation

Although fiscal deficits were both inevitable and appropriate during an economic downturn, in the long run maintaining a balanced budget is part of an obligation agreed by MS under the Maastricht Treaty. A balanced budget is fair towards future generations and helps achieving sustainable public debt trends. For countries in the Eurozone as well as countries aiming to become members of the Eurozone, the budgetary constraints set by the Stability and Growth Pact mean emphasis on sound government finances. It is important to keep in mind the Maastricht criteria, set by the Pact, even though there is an ongoing debate about the suitability of these rather inflexible criteria. However, most agree that we have to take into account the fiscal challenges and eventually get on a track of sustainable public finance. Measures of fiscal consolidation (exit strategies) are promoted internationally.^{11 12 13} OECD urges not to wait: "If the start of consolidation is postponed, the required improvement in budget positions will increase, which may undermine confidence and endanger the recovery".¹⁴

1.3.1 Risks of early fiscal consolidation

There also exist grounded opinions, which urge that drastic and too early fiscal consolidation measures come at a risk of falling back into crisis. The recovery at the private sector can be still uncertain, and cutting public spending too early might mean burning the only bridge to sustained economic growth. Leading in this criticism is the Nobel Prize winner economist Joseph Stiglitz, a former chief economist at the World Bank. He has warned against "deficit fetishism" of the cost-cutters. Quoting a EU Business article, he said that Europe "is facing disaster if it continues along this path".¹⁵

"The stimulus was always thought of as a stopgap measure until the private sector could recover. In some countries [...] politics rather than economics drove the size and design, with the result that they were too small and less effective than they might have been. Still, they worked. Now, financial markets – the same shortsighted markets that created the crisis – are focusing on soaring deficits and debts. [...] We should be clear. Most of the increase is not due to the stimulus but to the downturns and the bank bailouts. Those in the financial market are egging on politicians to ask whether we can afford another stimulus. I argue that [...] the world cannot afford not to have another stimulus. We cannot afford austerity [...] Critics say government won't spend the money well. To be sure, there will be waste – though not on the scale that the

¹⁰ Based on interview with CEEP official.

¹¹ See, for example, European Commission, DG ECFIN (2010) "Public Finances in EMU 2010", accessible at www.ec.europa.eu/finance/publications/2010/pdf/ee-2010-4_en.pdf

¹² See, for example IMF (2010) "From Stimulus to Consolidation: Revenue and Expenditure Policies in Advanced and Emerging Economies", accessible at www.imf.org/external/pubs/ft/dp/2010/dp1003.pdf

¹³ OECD (2010) "Preparing fiscal consolidation", accessible at <http://www.oecd.org/dataoecd/16/1/44829122.pdf>

¹⁴ Ibid.

¹⁵ EU Business (2010) "European budget cuts raise recession worries", Accessible online at <http://www.eubusiness.com/news-eu/finance-economy.4y4/>.

private sector in the US and Europe wasted money in the years before 2008. But even if money is not spent perfectly, if experience of the past is a guide to the future, the returns on government investments in education, technology and infrastructure are far higher than the government's cost of capital". (Joseph Stiglitz)¹⁶

This view is also voiced by President José Manuel Barroso in his speech in the Tripartite Social Summit (24 March 2011): "Fiscal consolidation is not an end in itself. It is a way to restore confidence and growth. It can not mean cutting essential public services or weakening our commitment to solidarity with the most vulnerable people in our societies".

In a related fact sheet we turn our attention to the potential solutions to and innovative ways of meeting the various challenges presented above and analyse briefly a few key sectors which provide SGIs viz. public transport, health care and childcare.

1.4 Interviews

Interview with Ms Edith Kitzmantel, Chair of the CEEP Macro-economic Committee

Interview with Mr Juan Pedro Marin Arrese, chair of the CEEP EMC Committee

¹⁶ Joseph Stiglitz (2010) "To choose austerity is to bet it all on the confidence fairy", article in the Guardian, 19 October 2010, available online at <http://www.guardian.co.uk/commentisfree/cifamerica/2010/oct/19/no-confidence-fairy-for-austerity-britain>



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