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New EU rules ‘may spell the end of politics as we know it’

The historical outcome of the European Council meeting held on Thursday was greeted with rare unanimous agreement by government and the opposition.

EU expert Roderick Pace (left) and veteran economist Karm Farrugia

By Jurgen Balzan

Opposition leader Joseph Muscat said in parliament that the Labour Party will continue to support government on the agreement reached in the European Council, as long as decisions on taxes are taken by the Maltese government.

The statement issued by the European Council proposes the establishment of a new fiscal rule which says that national budgets “shall be balanced or in surplus; this principle shall be deemed respected if, as a rule, the annual structural deficit does not exceed 0.5% of nominal GDP”.

The statement adds: “Such a rule will also be introduced in member States’ national legal systems at constitutional or equivalent level.”

MaltaToday spoke to economist Karm Farrugia and EU expert Roderick Pace and asked them to provide their initial reactions to the outcome of the protracted meeting between heads of member States held in Brussels on Thursday and Friday.

Veteran economist Karm Farrugia expressed his agreement with the proposals put forward by France and Germany in regards to the debt crisis. “The Franco-German initiative is not an act of imposition. France and Germany are showing a sense of leadership.”

Farrugia said that “the eurozone needs fiscal discipline in order to avoid any further financial crisis”.

Farrugia said that unlike other ‘sinful’ countries, Malta has been well behaved since joining the single currency. “However stricter fiscal discipline will ensure that all countries, including Malta, adhere to the rules. Some countries, especially Southern European countries tend to rely on creative accounting to balance their books. The recent crisis has demonstrated that the EU cannot take member countries for their word and rules will only be observed if the EU supervises and disciplines euro-zone member countries,” Farrugia said.

“I do not agree with the current administration on many issues, however this government has maintained budget discipline. The proposed fiscal discipline will ensure that Malta does not perpetrate the same mistakes committed by Greece, Italy and others.”

Farrugia agrees with the proposed 0.5% structural deficit ceiling and sees no problem in entrenching this rule in national legal systems at constitutional level. “I had proposed, with a few reservations, the entrenchment of similar rules 15 years ago. I have been advocating balanced budgets since then.”

With regards to the possibility of having a common taxation policy, Farrugia said he has very serious reservations, as normally such tax harmonisations have devastating effects on the smaller countries. According to Farrugia’s calculations, the Maltese economy cannot sustain a corporate tax exceeding 5% as this would deter foreign investors from investing in Malta.

Whilst reiterating his contrariety to a common taxation policy, Farrugia said Malta’s economy cannot introduce a corporation tax which exceeds 5% because locally registered companies are already paying a 35% income tax. “A corporate tax would make more sense if income tax is lowered to 25% and corporate tax of up to 20% can be introduced.”

Farrugia does not oppose a two-tier European Union in fiscal terms, as this already exists in other instances with the UK, Sweden, Denmark and other countries opting out of the single currency, the Schengen agreement and other accords. “A new treaty can be the salvation of Europe and prevent a potential break up."

University of Malta, told MaltaToday that the outcome from the meeting of EU heads of State was not spectacular.

Pace said that "the EU has moved another step forward, but doubts persist as to whether this European Council has finally made the euro safe. The proof of the pudding is in the eating and unfortunately the pudding is still being cooked."

"The markets will begin to react positively once the agreed measures begin to be implemented. European leaders need to do this properly and time is not an unlimited resource: they have very little of it," Pace said.

On the topic of stricter fiscal rules with measures restricting national debt to 0.5% of GDP, Pace said that the measure "may spell the end of politics as we know them in Malta. From here onwards, Maltese governments will have to ensure more efficiency in spending and in revenue collection, for it will become more expensive to ignore either one of them."

Pace added that present and future Maltese governments will have to deal seriously with the tax evasion culture, the public sector and address the acute political polarisation which often leads to inertia in tackling wasteful practices paid from the public purse.

On the cause of the recent eurozone crisis, Pace said that governments "will have to take a second look at the wasteful side of social and public service. Similar practices and clientalismo are what ruined the southern European countries. Citizens must also begin to accustom themselves (at last) that government is not the goose which lays the golden egg. Can we learn from the mistakes of others?"

In contrast to Farrugia, Pace does not agree with the entrenchment of a deficit rule to national laws and constitutions. "Ideally, we should not rely on such a legal provision... and insert it in the Constitution to boot."

However, Pace does agree with the intention of such an amendment because "after all, it is a measure of political prudence that governments balance their spending. But since governments do not spend their own but other people's money, they are under no pressure to behave prudently. So, much as I disagree with this legal approach to achieve healthier public finances, I do appreciate its salutary effects on governance."

With regards to tax harmonisation, Pace said he cannot comment on a treaty text that has not been written yet.

"The public is still in the dark as to the extent of the tax harmonisation intended and until that is known, we can only speculate. It all depends on the rates at which such taxes are pitched."

This week, Joseph Muscat opposed a common EU tax policy because it would endanger national sovereignty and go against the national interest. Pace claimed to I have difficulties understanding the meanings people attach to 'national sovereignty'… particularly in this age of increasing globalisation and interdependence."

"Personally, I attach more importance to the need to enhance individual security and freedom, to give people back the jobs they have lost, than to worry about 'national sovereignty'. In short, the priority is how to return Europe to healthy economic growth and not to debate the meaning of ‘national sovereignty’. Clearly, Europe can only overcome these challenges and progress further if the European states stick together,” Pace said.

Pace also spoke about Britain’s dissidence and said Britain’s self-imposed isolation does not translate into a two-speed Europe. Pace said that “back in the 1980s, when Spain and Portugal were joining the European Community, and Greece was already in it, some found it fashionable to refer to a ‘multi-speed’ or ‘two speed’ Europe, or a Europe of the hare and the tortoise, which turned the moral behind Aesop’s fable on its head.”

“More recently it was ‘core’ and periphery Europe. ‘Two speed’ Europe in the present context is being applied to the possibility unfolding before us of 26 European countries moving toward greater economic integration while one country holds back and prefers isolation. Hardly a ‘two speed’ Europe!” Pace said.

“I think it’s a case of self-imposed, probably unreasonable, isolation. A ‘two speed’ Europe was neither advocated by the Fathers of Europe nor by the founders of the eurozone, but if a member State refuses to get its back up off the wall and dance with the rest, do the others have to stop dancing?

In the end, for time alone will tell, Britain may be proved to have been right after all. The opposite is also likely – that they will discover that they have shot themselves in the foot by their action and they continue to lose influence in Europe. That is not good for Europe either. They are gambling as much as we who are in the Euro-zone are. I wonder whether they are correctly interpreting the historical phase we are passing through,” Pace said.