

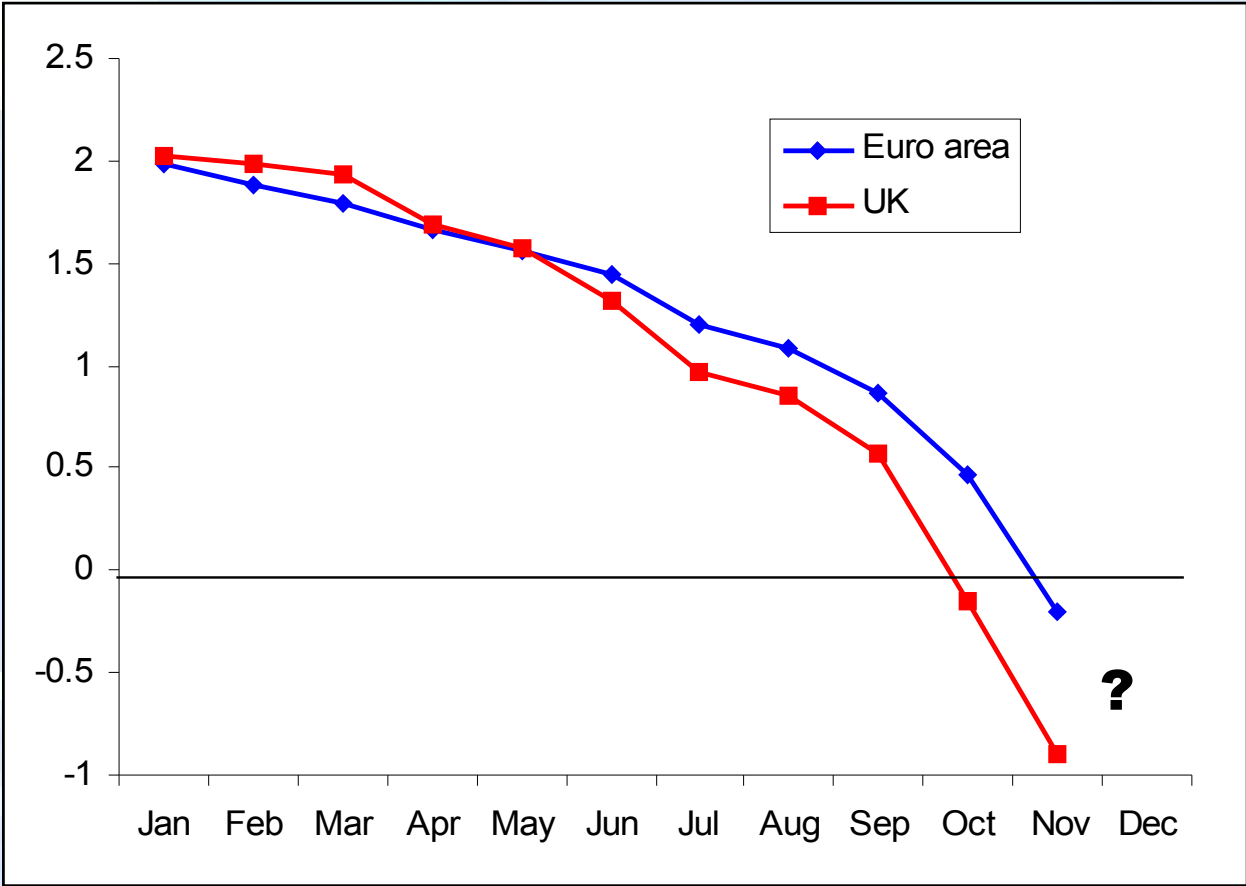
EUROPEAN COMMISSION
DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS

The EU response to the crisis

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Consensus forecast for 2009

GDP growth



Calendar of EU actions to date

- **7 October: ECOFIN raises deposit guarantee and declares that state aid rules and Stability and Growth Pact provide necessary flexibility.**
- **12 October: Heads of State or Government of the euro area countries agree on steps to restore confidence in the financial system.**
- **29 October: Commission adopts European recovery action plan, with details to be adopted on 26 November.**
- **7 November: Informal European Council ahead of the G20 Summit on the financial crisis on 15 November in Washington.**
- **19 November: Memorandum of Understanding on financial assistance to Hungary.**
- **26 November: Commission adopts European Economic Recovery Plan; call on Heads of State and Government to endorse it on 11-12 December.**
- **2 December: ECOFIN agrees on a coordinated European policy response to the financial crisis.**

The content of the plan

- **First pillar:**
 - *temporary fiscal impulse of € 200 billion (1.5 % of GDP) of which € 170 billion by Member States and € 30 billion EU funding*
- **Second pillar:**
 - *structural policies to improve competitiveness (labour markets, businesses, energy efficiency, clean technologies, infrastructure, innovation)*

Why two pillars

- Boost demand in the short run
- Boost growth in the medium run
- Smart policies do both

The first pillar

- **The three Ts**
 - *Timely: stimulus is needed now*
 - *Temporary: to avoid non-Keynesian effects*
 - *Targeted: credit-constrained households, permanent growth effects*
- **Co-ordination to maximise effects and ensure fiscal sustainability**

The first pillar

- **Mix of tax and spending measures**
 - *Temporary increase in transfers to most affected groups, frontloading public investment*
 - *Temporary guarantees and loan subsidies to rein in risk premium, fiscal incentives for greening the economy*
 - *Temporary cuts in labour taxes to boost disposable income and limit redundancies, temporary VAT cuts to stimulate consumption*

The second pillar

- **Employment support**
 - *Activation policies, targeted income support, skill matching, training and job placement, reduce social charges on lower skilled, lower VAT on labour-intensive services*
- **Business support**
 - *EIB lending to SME's, state aid decision making, temporary authorisation of subsidised guarantees and loan subsidies, cut red tape for start-ups, micro business, patents*
- **Infrastructure, climate and energy**
 - *Trans-European energy interconnections and broadband, accelerated structural funds, trans-European transport, EIB and EBRD funding of energy and climate investments, lower VAT for green products*
- **Research and innovation**
 - *European green cars initiative, European efficient buildings initiative, high speed internet*

The effects

- **With credit constraints, temporary fiscal expansions have a larger effect on demand in the short run**
- **Structural measures have strong output effects in the medium term**
- **Combining both, boosts growth in the short run and limits the fiscal burden in the medium run**

Estimated effects of the package: uniform approach

- **Assumptions:** government investment 1% of GDP and 40 bp lower cost of capital in year 1 and year 2, 1pp cut in price mark-up, 3% cut in wage mark-up, 10% cut in firms' administrative burden (all permanent)
- **Effects (%):**

		Year:	1	2	10
GDP	%		1.2	1.2	0.2
Employment	%		1.2	1.1	0
Real wage	%		0	0.2	0.2
Government balance	% GDP		-0.8	-0.8	0

A differentiated approach

- **Member states with sufficient fiscal space and strong competitiveness should focus on fiscal stimulus**
- **Member states with little fiscal space and weak competitiveness should focus more on structural measures**