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Cyprus and Malta join the euro area

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Editorial

Klaus Regling

Dear Reader

The EU is one of the world's most advanced and productive economies, but needs to constantly upgrade its performance in a competitive world. Something that has featured prominently in the economic debate over many years is its productivity gap with the US. Europe did narrow the gap over most of the second half of the 20th century, catching up particularly fast in the 1950s and 60s, but this trend was interrupted for a decade from the mid-1990s when the EU's productivity growth fell behind and America's surged ahead. This led to concerns about how to maintain and increase Europe's competitiveness and standard of living. The fact that in the last two years Europe's productivity growth has started to pick up speed again is therefore a highly welcome development and one which we in DG ECFIN have been analysing closely.

One of our findings is that much of the acceleration in productivity growth is due to the current cyclical upswing. Yet to meet the Lisbon Agenda target of a highly competitive economy it needs to be made sustainable. There is considerable scope to boost productivity further by promoting innovation, investing in education and training, intensifying ICT diffusion, fostering competition, and streamlining the single market. Some EU Member States and sectors are showing the way and have already achieved high productivity levels – the network industries in particular – while much of the remaining gap is concentrated in just a few sectors, notably services.

The higher economic growth the EU has enjoyed during the last two years has in large part been won through reforms in areas such as labour markets, business regulation and social welfare. Sustaining this growth in the future will only be possible through productivity gains as the population starts to shrink. It is therefore essential that the EU continues to tackle the root causes of low productivity growth.

Klaus Regling
Director-General, Economic and Financial Affairs DG

What's new

Gathering clouds and stiff headwinds…

Turbulence on the financial markets has led the Commission to moderate its predictions for EU economic growth in 2008, from 2.6% forecast in the spring to 2.4%. However, there are silver linings, suggested Commissioner Joaquín Almunia at the press conference to announce the new forecasts. "Clouds have clearly gathered on the horizon with this summer's turbulence in the financial markets, the US slowdown and the ever-rising oil prices," he said. "But thanks to strong world growth and solid economic fundamentals, the negative impact should be limited." Overall, the Commission expects the EU economy to 'weather the storm' and grow at close to its potential over the next two years. The autumn economic forecast and press release can be downloaded from the DG ECFIN website.

Poland at a crossroads


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Much has been achieved in reorienting the Polish economy, especially in the early years of transition, but real convergence has slowed down recently, both compared to the past and to the other new Member States. In particular, employment and labour-activity levels and investment were poor for many years. They have improved since EU accession, but they remain unsatisfactory. A DG ECFIN seminar in Brussels on 23 January 2008 and gathering researchers and practitioners dealing with Poland attempted to identify the largest obstacles to fast growth and the optimal policy response, with a particular focus on the role of public finances. More information on the seminar 'Poland: how can the economy benefit more from EU accession' can be found under 'events' on the DG ECFIN website.

IMF: Europe riding out the turbulence

The IMF has finally recognised Europe as a regular region with the inaugural publication of the first *Regional Economic Outlook: Europe* on 7 November 2007. Growth easing moderately and the need for more financial-sector, fiscal and structural reforms are the main elements of the report, which was launched by Michael Deppler, Director of the IMF's European department. "Clearly, the tendency of new financial products to exploit gaps in prudential frameworks can prove problematic," he said. "Nonetheless, financial innovation has been and will remain an important source of strengthened economic performance over the medium term." Summarising, he said that Europe is facing unexpected uncertainty (sic) and in weathering this episode policy-makers should not lose sight of the need to make progress on fiscal consolidation and structural reforms. The first *Regional Economic Outlook: Europe* can be found on the IMF website. **www.imf.org**

Helping out at home

The remittances that migrant workers send home are an important source of income for third countries, and one which can directly benefit families and communities in the developing world. Eurostat has collated data from the Member States to put a figure on the amounts involved – and they are quite significant. Migrants in the EU-27 sent about €26 billion to their former countries of residence in 2006, of which around €19 billion went outside the EU. Spain, the UK, Italy, Germany and France were the main remitting countries. According to an earlier study commissioned by DG ECFIN, the main destinations outside the EU were countries in non-EU Europe, North Africa, Sub-Saharan Africa and Latin America. The Eurostat Working Paper can be downloaded from **http://ec.europa.eu/eurostat** and the study financed by DG ECFIN from its own website.

'Beyond GDP'

This was the title of a Brussels conference held on 19 November 2007 to clarify which indicators are the most appropriate to measure progress, wealth and well-being. GDP is used widely, but as President José Manuel Barroso pointed out in his opening address, it was never intended to be an accurate measure of well-being – social and environmental indicators might be more inclusive. Indeed, the audience heard, wars and disasters can be accompanied by rising GDP. Organised jointly by the Commission, the European Parliament and other partners, the conference included presentations from a range of high-level speakers, including Commissioner Almunia and EP President Hans-Gert Pöttering. For more information see the conference website. **www.beyond-gdp.eu**

Delivery for the Deutsche Post

Speaking on 7 November at a conference of the Deutsche Post World Net, Commissioner Almunia gave participants a broad overview of the single market and the challenges it faces for the future, and in particular the achievements of Europe's network industries, such as the postal services his hosts deliver. "A truly integrated and competitive market for network industries is a key component of the dynamic single market that we are working towards," he told his audience, and explained that while market opening is often met by fears of lower standards, this is precisely why the universal nature of network industry services, such as postal services, is firmly anchored in many pieces of EU legislation. The presentation can be found on the Commissioner's website. **http://ec.europa.eu/commission_barroso/almunia/index_en.htm**

Small businesses, big currency

On 18 October 2007, DG ECFIN hosted a conference on 'SMEs and the euro', jointly organised with the European Association of Craft, Small and Medium-Sized Enterprises (UEAPME). The topic covered the preparations that small businesses need to undertake as their country moves to adopt the euro, including the measures that public authorities might implement to support them. In his welcome address, UEAPME Secretary-General Hans-Werner Müller warned against apathy arising from the success of the first-wave introduction that created the euro area. "They have to prepare properly; they don't have to reinvent the wheel," he said. The conference covered areas such as preparing IT systems, pricing strategies and communication issues; challenges that all busy SMEs will need to face in preparing for the single currency. For more information see 'events' on the DG ECFIN website.

Dialogue with China

On the occasion of the 10th annual EU-China summit, held on 28 November in Beijing, China's central bank governor, Zhou Xiaochuan, met Commissioner Joaquín Almunia, Eurogroup chair Jean-Claude Juncker and ECB President Jean-Claude Trichet to discuss co-operation in avoiding exchange-rate turbulence. The undervaluation of the renminbi does little to help the unprecedented strength of the euro and a growing EU trade deficit with China. Chinese Premier Wen Jiabao declared that "China will continue to perfect the renminbi exchange-rate regime in a gradual, proactive and manageable manner, give a further role to the market in determining the exchange rate, and will bring flexibility to the renminbi with a view to enabling capital account convertibility". These discussions come at the same time as Eurostat announced that EU-China trade grew by 150% between 2000 and 2006, making China the EU's second largest trading partner after the US.

http://ec.europa.eu/external_relations/china/intro/index.htm

A commemorative coin: click and vote

A special €2 coin is planned to celebrate the tenth anniversary of Economic and Monetary Union. It will appear at the beginning of 2009 and will have the same special design in all euro-area countries. Euro-area national mints have each sent their design proposals – from which a shortlist of four designs will be selected. In early 2008, these four designs will appear on a dedicated website set up by the European Commission where EU citizens and residents can vote for their choice – the design with the most votes wins. One lucky voter will receive a prize of a set of high-value euro collector coins. You will be able to access the designs and vote for your choice via the ECFIN website from the beginning of February.

Slovakia – a partnership for the euro

The European Commission and the Slovak authorities have signed a partnership agreement covering an information campaign on the introduction of the euro. The agreement, signed by Commissioner Joaquín Almunia and the Minister of Finance of the Slovak Republic, Ján Počiatek, entered into force on 7 December and involves cooperation in implementing communication activities on the euro to prepare the Slovak public and businesses for the eventual changeover. These can include media campaigns, conferences and seminars. Slovakia is targeting 1 January 2009 for adopting the euro – however, this will depend on the readiness of the Slovak economy and assessments by the EU institutions. For more information see the country page for Slovakia on the DG ECFIN website and the Slovak Ministry of Finance website **www.finance.gov.sk/**

Orava castle, Slovakia

A new DG ECFIN website

A new year and a new website for DG ECFIN. The new website collects all the information from the old website, which has grown organically over the years, and reshapes it into a clearer, more logical and more user-friendly structure. It has a bright new design, a pdf document search tool, more explanation of what we do and why, and sections aimed at the general public including a kids' corner for the younger economists. The new DG ECFIN website is located at the same internet address – so you do not need to search for it.

The euro area: regular report

The European Commission released its 'Quarterly Report on the Euro Area' on 18 December, which assesses the euro area's short-term economic outlook. Its focus section analyses euro-area productivity trends in industry, and shows that the relative weakness of productivity can be traced back to developments in total factor productivity (TFP) in a small group of industries. The report also analyses developments in inflation volatility, arguing that better macroeconomic policies have brought greater macroeconomic stability in the euro area. Other topics are the euro's evolving international role since its introduction, and structural reforms since the launch of the euro.

ECON hears warnings

Eurogroup chair and Prime Minister of Luxembourg Jean-Claude Juncker told the European Parliament's Economic and Monetary Affairs committee of his concerns at rising inflation and warned against 'benign neglect' as a response. Speaking to ECON on 20 November, Mr Juncker said that the strong euro has had limited impacts so far, but continued, "It would be naïve to say you can simply extrapolate this into the future". In response to MEPs concerns on protectionism he called it "a major risk for the economic growth of the planet." Commissioner Almunia, speaking to the committee on the same day, also highlighted the risks to growth, in particular inflation driven by rising oil and food prices, compounded by higher wage demands as employment rises. For more information see the website of the European Parliament.

www.europarl.europa.eu/committees/econ_home_en.htm

Further information

The latest news and press releases from DG ECFIN are available at:

http://ec.europa.eu/economy_finance/index_en.htm

Cyprus and Malta: two islands, one currency

On 1 January the citizens of Cyprus and Malta woke up to a new year and a new currency as their adoption of the euro became a reality. Thanks to the extensive practical preparations beforehand – which drew heavily on past experiences in other euro area Member States – Cypriot and Maltese citizens, businesses and authorities were well prepared, and well informed about the details of the changeover. Here, we present two invited contributions – from the Minister of Finance of the Republic of Cyprus, Michael Sarris; and from the Prime Minister and Minister of Finance of Malta, Lawrence Gonzi – who share their countries' experiences on the preparations for Economic and Monetary Union and the challenges and opportunities it offers for the future.

Cyprus: the challenges beyond euro entry

by Michael Sarris, Minister of Finance of the Republic of Cyprus

From 1 January 2008, Cyprus will have a new currency, the euro. The Cyprus pound, which has been legal tender since 1960, will cease to exist and will be replaced by the common European currency. This is a fundamental, albeit natural, change for a small economy, brought about by Cyprus' accession to the EU in 2004. The economy can reap important benefits from its participation in the single currency area, although it will face significant challenges. Everyone must play its role in this important journey, the government and the Central Bank, businesses, workers, and consumers.

Cyprus is now principally a services-based economy with strong links with the euro area and the EU. Its business cycle is highly associated with that of the euro area and its monetary policy has been linked to that in the common currency area since 1992, through a unilateral hard peg vis-à-vis the ECU and then the euro. Its geographic position offers important prospects for developing business links between the east and the west, and the changeover to the euro will undoubtedly play an important role in this process.

The economy has expanded steadily in the past years, supported by prudent macroeconomic policies and a dynamic private sector. Since 1992, the year in which the Cyprus pound was formally pegged to the ECU, growth has averaged 3.5% and inflation 3.25%. Unemployment has remained relatively low at around 4-5%, despite the sizeable inflow of foreign workers who today amount to some 18% of the labour force. The budget deficit averaged -3.25% but has displayed some tendency to follow political business cycles. In 2007, the fiscal position improved markedly and the general government will register a surplus of 1.5% of GDP, a very positive development which will further contribute towards reducing the public debt.

The accession to the EU in 2004 has brought about a fundamental tax reform which switched emphasis away from direct taxation (raised the tax-free income level, lowered marginal income tax rates, and introduced VAT at a standard rate of 15%), speeded up, and in many cases initiated, important structural reforms in labour, product markets and in the financial sector, and led to the creation of a credible policy framework which has further strengthened policies and bolstered macroeconomic stability. As a result, competition has been boosted in product markets and the dynamics of change have transformed the market place.

Importantly, EU accession has brought about fundamental reforms to the policy framework, both fiscal and monetary. A new monetary policy framework has been introduced and the statutory independence of the Central Bank of Cyprus has been strengthened further, based on the standard

"This is something the Cypriot and Maltese people can be proud of because they will become part of the largest monetary area of the developed world"
Joaquín Almunia, Commissioner for Economic and Monetary Affairs

required by the Treaty. In terms of fiscal policy, Cyprus has been obliged to meet the requirements of the Stability and Growth Pact (SGP), resulting in the implementation of a fiscal consolidation programme, first outlined in its Convergence Report in 2004. The fiscal deficit, which had reached 6.5% of GDP in 2003, was reduced gradually and turned into a surplus, estimated at 1.5% of GDP in 2007.

A principal challenge for the government inside the euro area is to maintain this strong fiscal position while, at the same time, strengthening the social safety net, redirecting resources towards growth-enhancing expenditure categories and improving physical infrastructure in various sectors of the economy. At the same time, fiscal policy should aim further towards consolidating the improved public finances, with a view to reducing public debt and thus addressing the long-term sustainability of public finances.

Overall, policies will have to support investment and private sector development, and to contribute towards the further enhancement of productivity and competitiveness of the economy. In this respect, the government can play a special role in reducing the administrative burden of regulations, promote R&D and investment and play a role in determining wages in the economy, through public sector wage setting. Labour market reforms must be undertaken to increase overall flexibility and allow businesses to operate in a business-friendly environment.

Monetary policy also faces challenges. Credit has expanded at a very strong pace since 2004 (averaging some 11%), both to residents and non-residents, financing a construction boom, which has continued unabated and has contributed to rising asset prices. The key challenge for the Central Bank of Cyprus (CBC) is to ensure that banking institutions avoid taking undue risk, especially by concentrating lending into one specific sector or activity, and continue to apply prudential safeguards on lending. These challenges for CBC policies will continue to be important in view of the fact that interest rates will remain relatively low over the coming months.

For the private sector the introduction of the euro will bring about increased competition, inside a large market with many players. Staying competitive will require changes in business models, investment in new technologies, innovation and expansion in other markets. These changes must be undertaken with careful preparation, taking into account evolving regional and global changes, including those in relative factor prices.

Workers and unions also have a critical role to play in this process. Wages constitute an important input in the production process, especially in a services-based economy. In this competitive environment wage increases must be accompanied by productivity improvements otherwise losses in competitiveness will bring about job losses and economic stagnation coupled with higher inflation. Experience from other countries reveals that while competitiveness can be lost relatively quickly, especially during periods of economic buoyancy, to regain competitiveness a country must go through a long and painful adjustment process during which the costs will be disproportionally high.

The economy of Cyprus is indeed in a very strong position and can reap important and lasting benefits from the adoption of the euro, though it will face significant challenges which can be addressed adequately with careful policy formulation and coordination. Sound policies have had a considerable impact in recent years, and will continue to lay the foundations for more growth and increased prosperity for all the citizens. Everyone must play an important role in this journey. ■

Malta: rising to the occasion

by Lawrence Gonzi, Prime Minister and Minister of Finance, Malta

Ever since Malta became a member of the European Union, the Maltese people have risen to the occasion of making the most out of EU membership. This entrepreneurial spirit was deeply grounded in the government's vision of making Malta a centre of excellence in the Mediterranean.

The euro brings clear and lasting benefits to the countries of the euro area. Only few years since its creation, the euro has delivered tangible success: not only is the euro a strong and credible currency for the euro area, but it is now the second most important international currency. The euro has contributed decisively to price stability. Additional gains brought by the single currency include low interest rates, the reduction of transaction costs and increased price and cost transparency which facilitates the functioning of the common market, leads to more integrated financial markets and increases trade.

For the above reasons Malta has striven hard to achieve the convergence criteria in the least time possible. This challenge has been met and today the smallest country in the European Union is a euro-area member fully committed to sound economic policies and bold reforms in line with the vision set out in the Stability and Growth Pact. We are convinced that for Malta, the economic benefits of the euro will be substantial. Having one of the most open and vulnerable economies,

with average import- and export-to-GDP ratios of over 80%, the euro will anchor us solidly in the European single market and provide a shelter from external shocks and volatility.

In July 2005, the National Euro Changeover Committee (NECC) was established by the Cabinet, with the clear brief of steering the technical preparations and the information campaign required to ensure that the country was adequately prepared in time for the adoption of the euro. Following the establishment of the technical groundwork through the publication of a series of guidelines, the NECC launched the euro information campaign on 6 June 2006. The effectiveness of this campaign has been tested through the Eurobarometer surveys commissioned by the European Commission. As demonstrated by the most recent survey, the information campaign has significantly contributed to a sharp increase in the level of awareness on the euro, which is also reflected in the level of support for the euro project amongst Maltese and Gozitan citizens.

Various concepts and innovative tools were used by the NECC in order to achieve a smooth and seamless changeover. Specific information campaigns targeted specific groups, including the business community, vulnerable groups, the elderly, children and consumers. These segments of the population were informed through specialised tools including ad hoc publications, web portals, corporate and information meetings (and in some cases one-to-one meetings), specific seminars and more focused advertising and public relations initiatives. A series of train-the-trainer sessions have had the desired multiplier effect. Teachers and carers, company management and directors, public sector heads and executives, euro assistants and volunteers were all a means of reaching out to all sectors of Maltese society.

A number of tailor-made tools were developed to address the needs of groups that could potentially require particular attention. A 'euro curriculum', including plastic euro-money kits and wallets given to all school children and vulnerable groups, led to greater familiarity with the euro notes and coins. As Malta is a country where religion plays a central role in social life, the NECC also worked closely with the religious authorities in order to disseminate the information to everyone.

The euro helpline attracted hundreds of callers on a daily basis. The euro website proved to be a key tool in driving the right message home. Information sessions by NECC officials were delivered in each and every locality during the last months of the campaign. These varied from business-oriented training sessions to assistance in household budget management to women at home and senior citizens.

The launch of the voluntary Fair Pricing Agreements in Retailing (FAIR) in January 2007 invited businesses to commit not only to adopt dual display prior to the mandatory period, but also to not increase prices due to the euro changeover. The vast majority of businesses have been awarded the FAIR trust mark. This is a pledge by businesses to their customers. Legislation and enforcement structures were in place to ensure businesses honour their FAIR commitments by mid-2007.

Another innovative initiative was the signing of price stability agreements with various importers, distributors and companies which voluntarily pledged not to increase prices between October 2007 and March 2008. These price stability agreements are intended as a tool to ensure transparency in pricing, to enhance consumer confidence and to continue promoting fair pricing.

We believe that the setting up of the National Euro Changeover Committee was a critical success factor in the management of the currency changeover. The NECC is recognised as the leading authoritative institution in charge of the complex task of managing the changeover. Its arms-length-from-government approach has enabled it to establish collaborative relationships and build by itself the necessary credibility required for its information and education campaigns to be balanced, apolitical and factual. The work of the Central Bank of Malta in spearheading the preparations for the logistical preparations related to the cash changeover should also be commended.

With the physical cash changeover behind us, there are elements that will still require particular attention during the first months following adoption of the euro. The need to keep up communications post €-day is crucial. The communication campaign must continue to dispel myths, replacing them with facts. Effective price-monitoring mechanisms will still need to be maintained to eliminate any potential for abuse during the dual-display period and beyond.

The European Commission's intention to ask Malta to document its euro communications strategy as an example of best practice to those other countries which are still aiming to join the euro area is a great source of satisfaction for the Maltese government.

Our successful path towards the adoption of the euro would not have been possible without the technical and practical assistance of the European Commission and the European Central Bank. To them we are undoubtedly grateful. We are, however, also indebted to the Maltese population who have been with the government through thick and thin to realise the euro project. Today, Malta stands proud to be placed at the core of European political, economic and social life. ■

Further information

More information on the economies of Cyprus and Malta can be found on the Member States' country pages on the DG ECFIN website

http://ec.europa.eu/economy_finance/index_en.htm

More for less: the productive path to prosperity

The EU is one of the world's most productive economies. However, since the mid-1990s, a transatlantic productivity gap has emerged. Although productivity growth has picked up in the past two years, this is largely cyclical and, consequently, the Union must persevere with and enhance certain aspects of its current reform strategy if Europe is truly to overcome its productivity problems.

The European Union is one of the world's most competitive and innovative economic areas and scores highly in global rankings, both in terms of output per worker and real per capita income. It is this capacity to innovate, to create new products and services, and to do things better and more efficiently through process innovation that is at the heart of European prosperity.

However, the EU has lagged behind the United States in the productivity stakes since the mid-1990s. Moreover, increasing globalisation and the rise of major new economic powers, such as China and India, are also putting pressure on Europe, particularly as its faces the additional challenge of a greying population in the coming decades.

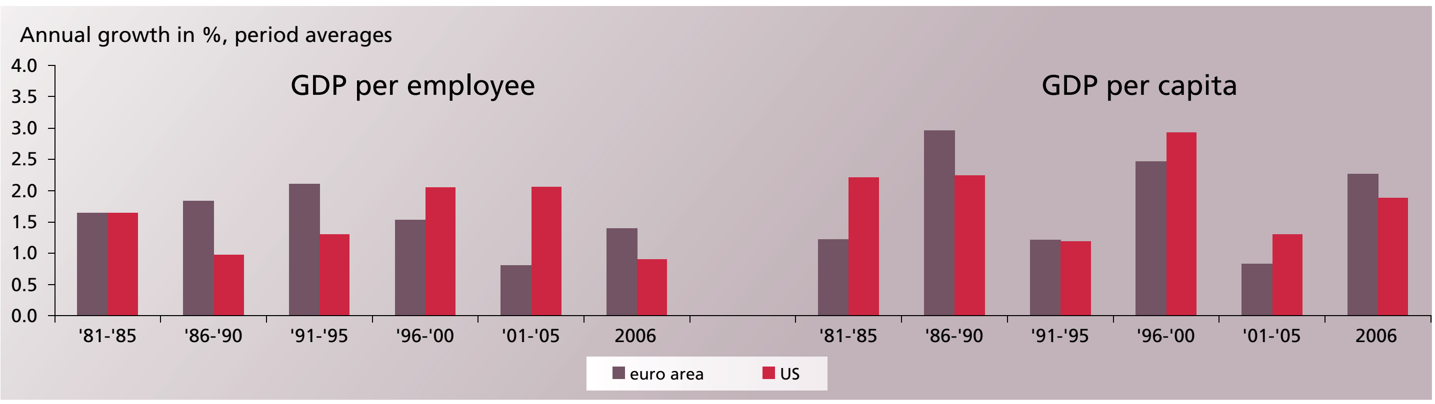
The need to boost productivity has been an integral part of the European economic reform process set in motion by EU leaders in the Portuguese capital in 2000. This Lisbon Strategy has sought to transform Europe into a leading knowledge-based economy through structural economic reforms and boosting the Union's innovative capacity. The relaunched 'Lisbon Strategy for Growth and Jobs' in 2005 also stressed the importance of productivity growth.

"We must now accelerate the momentum for reform… we need to match the rapid pace of change brought by globalisation and ageing, with urgent reforms that will continue to boost productivity and growth, raise employment and strengthen society," said Joaquín Almunia, European Commissioner for Economic and Monetary Affairs. "To be ready to benefit from globalisation, Europe needs to sharpen its competitive edge. And the key to improving Europe's competitiveness is improving productivity."

Mapping Europe's productivity frontier

Given the paramount importance of productivity to Europe's future prosperity, DG ECFIN decided to dedicate the 2007 EU Economy Review, entitled 'Moving Europe's Productivity Frontier,' to this question. European productivity has been on a more-or-less upward trajectory since the end of World War II. However, the rate of growth has experienced its fair share of swings and roundabouts. In the 1950s and 1960, it rose rapidly, slowed in the 1970s, picked up again in the 1980s to mid-1990s, and then slowed once more.

GDP per employee and GDP per capita in the euro area and the US



Source: European Commission.

"To be ready to benefit from globalisation, Europe needs to sharpen its competitive edge. And the key to improving Europe's competitiveness is improving productivity."

European Commissioner for Economic and Monetary Affairs, Joaquín Almunia

This is seen in the chart which shows productivity developments as measured by GDP per employee and GDP per head of population.

Of course, this general picture conceals a complex reality: Europe's best-performing Member States are actually experiencing healthy productivity gains – some have instigated reforms that will pay off in the coming years, while others lag somewhat behind. In addition, the transatlantic gap is actually focused in a narrow range of sectors. In fact, in some sectors, such as the so-called network industries (utilities, transport, communications, etc.), the EU's performance is significantly ahead of the United States.

"The productivity gap can be traced back to quite a limited number of industries, particularly services," explains Karl Pichelmann, a research adviser at DG ECFIN who worked on the review. "Much of the US productivity growth is due to growth in the ICT sector itself, which is considerably larger than in the EU."

Upswings and cycles

The last couple of years have seen a renewed acceleration, as the chart shows. "Since 2005, we've witnessed a rise in productivity growth," observes Pichelmann. "Does this mean we've turned the corner? Are structural reforms finally paying off or is it a cyclical rise?"

It seems to be a bit of both, the review concludes. "Eliminating the cyclical component from productivity growth shows that a large part of this apparent acceleration must be attributed to the cyclical upswing which the EU economy has enjoyed in this period," it notes.

"A plausible explanation for this is that in the early phases of an economic upswing additional demand is met by enterprises making employees work more efficiently (and longer hours)," the report suggests. However, "As the upswing matures and to the extent that the recovery is perceived as lasting, companies increase hiring… leading to a slower growth of output per person employed."

Some analysts have linked sluggish productivity growth over the past decade or so with the unprecedented rise in employment levels. "The

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report shows that employment growth has shaved a little bit off productivity growth. But what may look like a trade-off is only temporary," Pichelmann explains. In fact, the review stresses the fact that improving productivity and creating jobs can, and do, go hand in hand, especially if new technologies and work processes are diffused rapidly.

Destination Lisbon

In the seven years since the Lisbon Strategy was launched, EU Member States have progressed some way towards implementing the reforms it outlines. These reforms have helped Europe to retain its competitive edge, create jobs and economic growth, and account for some of the productivity gains it has experienced. Moreover, given the long-term nature of the reform process, many of the pay-offs have not yet matured.

"The report confirms the importance of the priorities set in the Lisbon Agenda. I think we can be quite confident that, sooner or later, we will reap the benefits of our efforts," Pichelmann points out. "But it is clear that there is no room for complacency. We must continue to push ahead with implementing the Lisbon Strategy."

In fact, most of the recommendations made in the review chime with the priorities of Lisbon. The report concludes that Europe needs to redouble its efforts to boost R&D investment, build knowledge and bolster its innovative capacity. This requires major investments in human capital, including lifelong learning and enhancing labour mobility. It also stresses the importance of creating the right competitive environment by making it easier for firms to enter and leave the market, improving access to capital and removing the stigma associated with business failure in order to encourage more entrepreneurship. ■

Taking productivity personally

To many people, 'productivity' sounds like a code word for 'work harder' or 'work longer hours', and many may not be aware of how higher productivity might benefit them.

Better productivity does not equate with more work – quite the contrary. It means producing more for a given amount of effort, time and resources. So, what does rising productivity mean to 'ordinary folk', and why does it matter?

Well, a more productive firm or economy is a more competitive one and, hence, more likely to survive and thrive. In addition, in a globalised economy, Europe, with its high labour costs, cannot compete with emerging rivals in this area, so it needs either to produce innovative products for which it can charge an 'innovation premium' or become more productive. Productivity gains improve profitability and ultimately lead to wage increases, although sometimes firms may not immediately pass these on to their workers.

Some worry that by trying to emulate US productivity levels, Europeans would lose some aspects of their cherished lifestyle of shorter hours and longer holidays. But "high productivity growth can be consumed in the form of higher real incomes or increased leisure," explains Pichelmann.

Further information

The 2007 EU Economy Review can be downloaded from

http://ec.europa.eu/economy_finance/publications/publication_summary10132_en.htm

Shifting Lisbon into an upward cycle

The Commission's strategic review of the relaunched Lisbon Strategy's first three years has good news for the Union, but the next three-year cycle will need to keep up the pace. The review therefore sets out a whole series of clear and coherent recommendations for accelerated reform.

The Monument to the Discoveries in Belém, Portugal: celebrating a successful earlier Lisbon Strategy

The Lisbon Strategy is one of the EU's most ambitious policy vehicles. When it was launched in 2000, this ten-year plan's express aim was to transform the Union into the world's most competitive knowledge-based economy and society.

Achieving this extensive objective required a far-reaching agenda which touched on a broad spectrum of policy areas, including macro- and microeconomics, fiscal policy, employment, research and development, education and training, and the environment and energy, among others.

A mid-term review of Lisbon found that, although progress was being made, there remained quite a few crucial areas in which the EU was falling short of the Strategy's ambitions. In 2005, Union leaders rallied to the cause to put Lisbon back on track and relaunched it with a renewed focus on economic growth and jobs.

"Lisbon has moved from a top-down approach to a partnership one in which Member States formulate their own national strategies in collaboration with the Commission," says Declan Costello, of DG ECFIN. "There is also a closer alignment of national and EU policies that aim to raise growth and jobs potential."

Owing to the longer-term nature of the reform process, they also agreed to implement Lisbon in three-year cycles instead of the previous annual ones. The first cycle is winding up and the Commission has been assessing its outcomes. So, how has the EU fared?

Staying the course

The Commission adopted the Lisbon Strategic Report on 11 December 2007. The review identified progress in a number of key reform areas, enhanced economic performance, especially as regards employment, and improved national ownership and governance of the Lisbon process.

During this cycle, the EU economy has become more buoyant, with growth picking up pace and a sustained rate of job creation, especially among women and older workers aged 55 and over. Public finances have also improved significantly, with combined public deficits dropping from 2.5% in 2005 to a projected 1.1% this year. However, the pace of budgetary adjustment appears to be slackening off and questions remain regarding the long-term sustainability of fiscal policies.

"The economic situation today is considerably better than it was in 2005 and employment has risen significantly," explains Costello. "However, the downside risks have increased in recent months linked to the state of the financial markets, which is some cause for concern." The review notes that there has been progress with macroeconomic reforms in this cycle, but there is some evidence of a slowdown in the rate of change in the last 12 months or so. "Reforms are easier to implement when times are good but the temptation is also greater to take your foot off the pedal," Costello continues. "The EU must stay the course, especially given the competitive pressures in a rapidly changing global economy and as the effects of population ageing take hold."

According to Costello, one impact of the Lisbon Strategy has been to increase the focus on various microeconomic ingredients that make up a vibrant economy. There has been a wide consensus in Europe, for many years, that macroeconomic stability and reforms of the labour market were needed to boost growth potential. However, Lisbon has succeeded in shifting attention towards other equally important policy areas, such as knowledge, R&D, innovation, SMEs, service reform, etc.

Although only a few Member States have reached the ambitious investment targets for research and innovation agreed by EU leaders, there has been progress. "Most countries are investing more in R&D and are starting to develop more coherent innovation strategies," stresses Costello. "There has been a lot of headway in efforts to reduce the administrative burden on businesses and the adoption of the Services Directive is potentially a major development in the offing."

One of the defining successes of this cycle has been the increasing national ownership of the Lisbon process, which was lacking up to 2005. In a bid to promote national ownership and better governance, the relaunched Strategy invited Member States to

"The Lisbon Strategy is helping position Europe and European citizens to succeed in the age of globalisation"

President of the European Commission, José Manuel Barroso

formulate their own national reform strategies which prioritise the Lisbon objectives according to a country's own particular situation. "With these national strategies, you now sense a greater degree of involvement by Member States in tackling the remaining challenges," Costello observes.

No room for complacency

The review's main message is that, despite the progress that has been achieved, Member States really need to accelerate the reform process. "There's a risk that, if we become complacent, our economies will not remain competitive," Costello cautions.

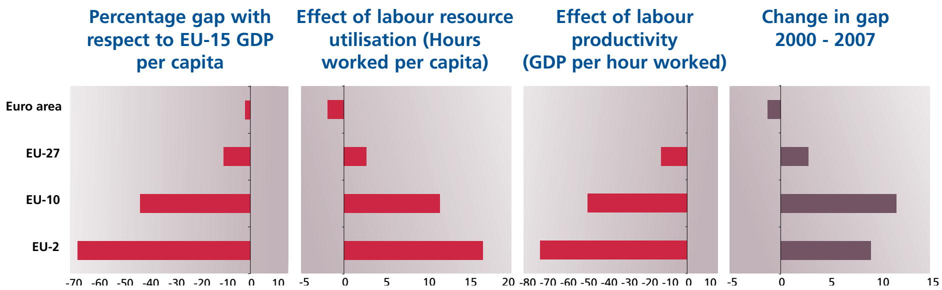
Structural reforms are often complex and it can take a long time to enact changes in sensitive areas, such as the labour market or pension schemes. This makes it a challenge to sustain political momentum behind the Lisbon Strategy, and to avoid being crowded out of the political agenda by more pressing issues.

To address the need for a sustained focus on structural reform over the medium to long term, the Commission has invited countries to focus their reform efforts on four priority areas in the coming three years: energy and climate change; R&D and innovation; flexicurity (i.e. labour market flexibility coupled with social security); and the business environment, particularly for SMEs. In its strategic report, the Commission will also present a new Lisbon programme structured around the same priority actions, and has invited all other EU institutions (including the Council of Ministers and the European Parliament) to back these proposals.

Another area that requires attention in the coming years is employment policy. The chart shows how different EU Member State groupings have utilised their labour resources vis-à-vis the EU15 (pre-2004 EU). Citizens of the new Member States (EU10 and EU2) work longer but not as productively as the EU15 average, although the gap is narrowing.

Although the increased flexibility in labour markets has created millions of new jobs, certain problems have emerged. New entrants to the labour force in some Member States are often employed on temporary contracts, while existing workers remain on the same highly protected contracts they had before. This promotes a two-tier system that can harm younger workers and discourage investment in training and skills. The Commission has recently proposed a flexicurity-based approach to reforming labour markets in the EU. This seeks to increase flexibility in labour markets so that resources in economies are reallocated towards more productive activities, while providing labour market rather than job security to workers. ■

The sources of real income differences: 2007



Further information

The Lisbon Strategic Report can be downloaded from
http://ec.europa.eu/growthandjobs/european-dimension/200712-annual-progress-report/index_en.htm

Ten years of Economic and Monetary Union: so far so good?

New Year's Day 2009 will not be just the start of another year; it will also mark the tenth anniversary of the launch of Economic and Monetary Union and the single currency on 1 January 1999. To mark this important anniversary the European Commission is completing a strategic review of EMU after ten years – under the heading EMU@10.

This wide-ranging review will investigate the extent to which EMU has overcome obstacles, met challenges, and fulfilled its promise so far. In particular it will answer questions such as:

- What has been the impact on long-term growth and employment?
- What are the long-term perspectives for the euro?
- Do we have integrated financial markets under EMU?
- Has the euro-area policy mix been the right one – and is it fit for the future?
- What have been the spillover effects across the euro-area Member States?
- Have reforms helped stability and the capacity to adjust to economic shocks?

Along with Commission staff, many distinguished economists are contributing to the EMU@10 strategic review. The review process will culminate in the publication of a Communication from the European Commission to the Council in spring 2008, which will highlight what has been achieved, what has worked well, where more work is needed, and what lies in store for the future.

The following issue of *European Economy News* – available in May 2008 – will be devoted to the issues and findings of EMU@10. ■

The economy of Germany: powered by reform

As the largest economy in the EU, Germany's economic performance is of concern to all. However, for the past 15 years it has faltered, partly owing to the burden of German reunification, but also to earlier, growing structural deficiencies. Today, after a long convalescence, it is now powering ahead. The question is whether it has reformed itself deeply enough to ensure a return to the sustained high growth rates of the past – an issue that was analysed in a recent seminar organised by DG ECFIN.

The past 15 years have proved a bumpy ride for the German economy – a stark contrast to the soaring economic performance of most of the second half of the last century. Despite the repeated oil crises, the German economy ended the 1980s with strong growth rates of over 3.5%. However, even back then, there were signs of trouble ahead – an onerous welfare state and a rising unemployment trend indicated growing structural problems in the economy.

Reunification – an act of remarkable political solidarity – was a major challenge to German economic performance in the 1990s because it caused an additional drag on economic performance and exacerbated the structural deficiencies that had been building, shown, notably, by accelerating unemployment. Massive transfers to boost living standards in eastern Germany abruptly raised demand and sparked an initial boom. However, higher wages and inflation generally reduced Germany's price competitiveness and export performance. At the same time, public finances were strained as 4-5% of GDP went eastwards for reconstruction and income support – which kept taxes high. And it was not only funding that went eastwards; the pre-existing structural deficiencies that had been growing in the West also went – putting an unwelcome brake on the East's prospects for sustainable growth.

The slow climb back

By 1992, tight monetary policy by the Bundesbank had contained inflation, but high labour costs and taxes contributed to stagnating growth in western Germany, which slowed from over 4.6% in 1990 to around 2% for the rest of the decade, reaching a nadir of 0.75% in the first five years of the 21st century. Understandably, the reunification process brought forward a severe bout of economic indigestion – but the German economy then took extended sick leave to recover.

Following a period of excessive wage increases up to the mid-1990s, economic recovery relied heavily on a decade of strong wage moderation. As a result, since 1995, German unit labour costs have fallen by around 20% compared with its major trading partners. However, until price competitiveness was fully restored, high unemployment persisted and job creation was weak, driving widening government deficits. In response, the government reined back expenditure, but also cut taxes in the hope of stimulating domestic demand.

However, rising social security contributions to pay unemployment and other welfare benefits squeezed industry, which responded by under-investing, shedding more labour, and even relocating operations overseas. Moreover, in view of low wage rises, fear of unemployment and doubts about the sustainability of the welfare system, domestic consumers simply did not want to spend. So, with industry and consumers both disinclined to kick-start a demand-led recovery, and a shrinking, post-boom construction sector, the economy remained stuck in a low-growth-low-expectations trap until well into 2005 – despite the restoration of price competitiveness.

As a consequence, the government deficit rose above the '3% of GDP' ceiling set in the Stability and Growth Pact, meaning Germany was placed in the 'excessive deficit procedure' for four consecutive years (2002-2005).

In this environment, in 2003-2005 the government implemented its Agenda 2010 social security reforms, designed to strengthen incentives for hiring and taking up work.

On the rebound – but for how long?

The extended period of economic convalescence came to an end in 2006 when German growth leapt to 2.9%, from 0.8% in 2005. Restored price

Martin Luther: an earlier German reformer

competitiveness, the earlier reforms and the fading reunification burden have now translated into a strong recovery including falling unemployment, more jobs, expanding trade and budget balance restored. And the 2007 autumn economic forecast from DG ECFIN predicts the recovery will be sustained through to 2009.

However, a big question mark hangs over the German economy today. Is this recovery the beginning of a new era of sustained growth, or is it just cyclical, part of a boom-and-bust cycle? This issue was investigated in a DG ECFIN country study published in 2007 – *Raising Germany's growth potential* – and was also the subject of a recent DG ECFIN seminar – *Germany: from the sick man to the powerhouse of Europe?* – where key speaker Michael Burda of Berlin's Humboldt University warned, "The good news is that Germany – the central motor of the EU – is growing again. Reforms have had a significant effect. The bad news is that there is a growing temptation to backslide because the economy and tax revenues are growing again." While some reforms have been made, the burning question for economists is whether these are enough to ensure sustainable growth in the future. In the

"The process of structural reform has contributed significantly to the higher growth and employment in Germany"

Klaus Regling, Director-General of DG ECFIN

Germany
(Deutschland)

Currency: euro
Population: 82.5 million
GDP per capita in purchasing power standards (EU-27=100): 114% (2006)
Real GDP growth rate: 2.9% (2006)
Public sector deficit (as a % of GDP): 1.6% (2006)
General government debt (as a % of GDP): 67.5% (2006)
Source: *European Commission*

past 15 years, German economic growth has exceeded 3% only once, yet before that time growth rates over 3% were normal. Significantly, what has been restored in Germany is price competitiveness relative to its trading partners, but as DG ECFIN Director-General Klaus Regling pointed out to the seminar audience, "The reliance on wage moderation alone cannot be regarded as a promising long-term strategy".

Improving structural competitiveness

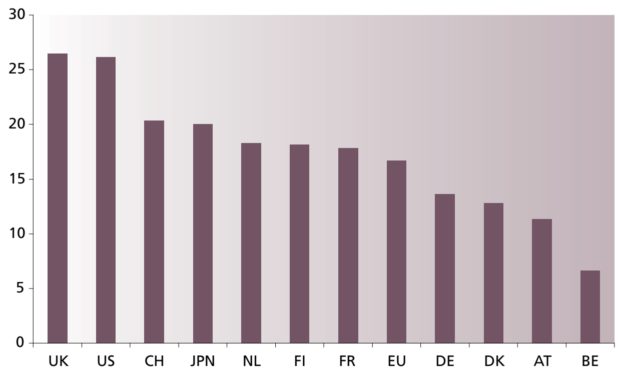
To investigate future growth potential, DG ECFIN economists have used a growth accounting model that identifies the relative contributions of three factors: capital and labour, and 'total factor productivity' – which is related, among other things, to the use of technology. Their analysis identified three structural impediments to sustained growth: rigidities in the labour market; finance and taxation for businesses; and innovative capacity.

German centralised wage bargaining has been a strength in the past. However, while facilitating overall wage moderation and ensuring distributional equity, it also makes wages less responsive to differences in firms' profitability, labour productivity and regional demand and supply conditions. This situation is compounded by the high 'tax wedge', meaning the high social contributions that drive a 'wedge' between high labour costs for employers and low take-home pay for employees. The German tax wedge is well above the EU average and discourages recruitment as well as acceptance of low-paid jobs. "The standard work contract is still burdened with high social charges and is still highly regulated," concluded Ulrich Walwei of the German IAB in his seminar presentation.

There are also impediments to business investment. Traditionally, established companies have built close links with local banks for their financing needs, but this route is less suitable for the small innovative start-ups that Germany needs to encourage for the future. Germany lacks the vibrant risk capital markets of its successful trading partners. Furthermore, high company taxes are compounded by a complicated tax code, which places a heavy administrative burden on small and medium-sized firms in particular. Tax reforms in 2000 reduced government revenues but did little to improve the investment climate – more is expected from a tax reform in 2008 that will bring the effective corporate tax rate down, from 39% to 29.8%, closer to the EU average.

The significance of these structural impediments was hinted at by German economist Michael Frenkel at the DG ECFIN seminar, who said "Germany's unemployment problem does not seem to be related to intensified globalisation. Indeed, GDP growth would have been smaller with less open markets."

High-tech exports as a percentage of total exports



Wider innovation needed

"Germany needs to reinforce its innovation system," explains Georg Busch of DG ECFIN. "While Germany is very strong in traditional industries and scores highly on some innovation indicators, innovation itself is not widespread, is concentrated in relatively few companies and leans towards cost reduction rather than new products and services." This can be seen in the level of high-technology exports from Germany, which is below the EU average (see chart). An example of what is needed comes from tertiary education, says Busch. "The German university system, which performs well on conventional indicators, needs to support the diffusion of innovation and R&D more, and thus future growth. It also needs to produce more engineers – German industry is saying that it could produce more if it had the qualified staff."

A window for the future

Implementing a comprehensive reform agenda would help ensure that German economic growth could regain its earlier high rates and be sustainable for the future. But experts are concerned. "The process of structural reform has contributed significantly to the higher growth and employment in Germany," Klaus Regling told seminar participants, but he warned, "Signs of reform fatigue are particularly worrying: proposed corrections to the reforms risk turning low-wage earners into no-wage earners". The economic difficulties of the last decade have raised awareness of the need for reform among the German people and workers, and the hope is that sufficient political commitment and the current brighter economic outlook should enhance popular acceptance of reforms and their chances of success. ■

Further information

More information, including the country study on Germany, can be found on the Member States' country pages under 'EU economic situation' on the DG ECFIN website:
http://ec.europa.eu/economy_finance/index_en.htm

Looking ahead

For your diary

10 March 2008, a conference in Brussels

European and Asian integration: achievements and challenges

Jointly organised by DG ECFIN and the Asian Development Bank, this conference will compare progress in financial and monetary integration in Asia and Europe over the past two decades. It includes sessions on economic integration and regional financial stability and the policy implications of regional integration and macro-economic adjustment. The final session will be a discussion on emerging Asian regionalism. Speakers will come from Europe and Asia, and Haruhiko Kuroda, President of the ADB, will give opening remarks.

March 2008, Brussels European Commission conference

Public finances in the EU

The European Commission, through its Bureau for European Policy Advisers (BEPA), will organise a major academic conference that will focus on the economic aspects of EU budgetary spending and financing, from the perspective of the long-run development of how the EU is funded. Issues to be covered include: the main factors affecting EU policy priorities, the assignment of policy responsibilities between EU, national and regional levels, possible EU taxes, and decision-making on the budget. For more information see the BEPA website: **http://ec.europa.eu/dgs/policy_advisers/index_en.htm**

13 March 2008, a workshop in Brussels

Extending the working lives of older workers: a European success story?

At this workshop, organised by DG ECFIN, participants will discuss issues such as: measuring pension entitlements, the implications of pension reforms on labour markets, and the complementarities between pension and labour market reforms. The aim is to debate the policy challenges posed by an ageing population and the sustainability of pension systems – and the appropriate policy responses.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17-18 March 2008 in São Paolo, Brazil, a euro conference

The euro: global implications and relevance for Latin America

This DG ECFIN conference will consider the implications of EMU and the euro for other parts of the world, in particular Latin America. Exchange-rate regimes, expanding trade and investment between the EU and Latin America, including Mercosur, and the relevance of the EU experiences in financial integration for Latin American regions will be discussed. High-level speakers from the EU, including Commission President José Manuel Barroso, Latin American countries and international institutions will participate.

27-28 March 2008, a workshop in Cambridge, UK

Euro-area data: issues and implications for economic analysis

The ninth workshop of the Euro Area Business Cycle Network (EABCN), hosted by the University of Cambridge, will discuss methodological issues such as the aggregation of data from across the euro area and the use of real-time data and the impacts these can have on economic analysis. For more information see the website of the European Central Bank: **www.ecb.int**

24-25 April 2008, at the ECB in Frankfurt

A strategic vision for statistics: challenges for the next ten years

This fourth ECB conference on statistics will consider the role of statistics in monetary and other economic policy-making, the future directions for collecting and compiling statistical data, and future avenues for co-operation in the field between the ECB and the European Commission. The conference will also discuss how best to communicate statistics to the general public. ECB President Jean-Claude Trichet and EU Commissioner for Economic and Monetary Affairs, Joaquín Almunia will contribute to the conference. For more information see the ECB website: **www.ecb.int**

24-25 April 2008, Washington D.C., an IMF conference

International macro-finance

Organised jointly by the International Monetary Fund and the UK Economic and Social Research Council, this conference will hear recent research on approaches to international financial issues including: managing capital flows, liquidity and credit risk, and exchange rates and financial markets. The aim of the conference is to stimulate innovative methodologies and their diffusion in the analysis of relevant policy issues. For more information see the IMF website: **www.imf.org**

14-15 May 2008: The Brussels Economic Forum

Economic and Monetary Union in Europe: 10 years on

To mark the tenth anniversary of the launch of EMU this year's BEF, organised by DG ECFIN, will take the experiences, challenges and successes of the first decade of EMU as its topic. Speakers will include EU leaders and economists who were involved in the preparations for EMU, including Tommaso Padoa Schioppa, Pedro Solbes and Theo Waigel. IMF President, Dominique Strauss-Kahn, will give a keynote address.

Further information
http://ec.europa.eu/economy_finance/events/

Commission agenda

In February

Commissioner Almunia will participate in the G7 Finance Ministers meeting in Japan.

In February

DG ECFIN will publish its interim economic forecast for the EU and the euro area. Interim forecasts are published between the major spring and autumn forecasts and are updates based on more limited data. They only project growth and inflation one year ahead and are based on data from the larger Member States. The interim forecasts can be downloaded from the DG ECFIN website.

In May

There will be a high-level meeting between the ECOFIN Council and candidate countries. The pre-accession economic programmes (PEPs) of the candidate countries, including Croatia, the former Yugoslav Republic of Macedonia and Turkey will be on the agenda. PEPs are an instrument to accustom candidates for EU membership to the monitoring and surveillance regimes of the SGP.

In the spring

On behalf of the Commission, DG ECFIN will complete its assessments of the updated Stability and Convergence programmes of the Member States. Euro-area members produce stability programmes that track their compliance with the agreed targets of the SGP. Euro-area candidates produce convergence programmes that demonstrate the extent to which their economies are converging with the euro area. The ECOFIN Council will discuss the Commission assessments, which will be published in three lots in January, February and March.

In March

DG ECFIN, on behalf of the Commission, will publish a Communication on the introduction of the single currency in Cyprus and Malta at the beginning of 2008. This will report on the successes and challenges of the changeover process and, in particular, the implications for other Member States that are preparing for euro adoption. The Communication will be followed by a DG ECFIN conference on this topic in May 2008.

In April

DG ECFIN will publish the spring economic forecasts for the EU and the euro area. These two-year projections of macroeconomic indicators are published twice a year, in the spring and the autumn, and provide a basis for analysis and policy-making. The 2008 spring forecast will be available in May on the DG ECFIN website.

In May

The Commission will publish a report on economic and monetary union after ten years – EMU@10. The report will analyse the successes of the single currency, and what has not worked so well, as well as looking to the future. It will also summarise developments in the euro-area economy over the past year. Ten years of EMU will also form the topic of the Brussels Economic Forum to be held in May.

Editorial information

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Recent research and analysis by DG ECFIN

European Economy Research Letter

The Directorate-General for Economic and Financial Affairs publishes a regular web-based newsletter on the research activities of its staff – the European Economy Research Letter. Topics from the most recent edition include: The 2007 ECFIN annual research conference on growth and income distribution in the EU, rapid convergence and imbalances in Spain, and the impact of a carbon constraint on energy-intensive industries. The European Economy Research Letter is available free of charge by e-mail subscription on the DG ECFIN website: **http://ec.europa.eu/economy_finance/publications/specpub_list9246.htm**

Research publications

DG ECFIN also publishes frequently on economic research relevant to the European Union which is conducted by staff of the DG. These publications appear as part of the *European Economy* series, available as print and web versions. The main *European Economy* series includes major reports and communications to the Council from DG ECFIN on behalf of the European Commission.

Within the *European Economy* series, *Economic Papers* and *Occasional Papers* cover the analytical and policy work done by the staff of DG ECFIN, sometimes in co-operation with external researchers. The *Country Focus* series covers topical economic issues affecting one or more Member States. Some recent titles are:

Economic Papers

Recent publications include:

Price convergence in the enlarged internal market

By Christian Dreger, Konstantin Kholodilin, Kirsten Lommatzsch, Jirka Slacalek (DIW Berlin) and Przemyslaw Wozniak (Centre for Social and Economic Research, Warsaw). European Economy, Economic Papers, No 292, November 2007, European Commission. ISBN 978-92-79-04645-2

This paper investigates the effect of the EU-10 enlargement on price convergence within the internal market. It distinguishes opposing forces: the catching-up effect of the EU-10 which should raise price levels, and increased competitive pressure on prices from lower mark-ups which should lower price levels. Using comparative price levels for the EU-25, the results confirm the presence of price convergence.

More titles…

- Pension systems, ageing and the Stability and Growth Pact
- The track record of the Commission's forecasts – an update
- An overview of the EU KLEMS growth and productivity accounts

Occasional Papers

Recent publications include:

Pension schemes and projection models in EU-25 Member States

By the staff of DG ECFIN. European Economy, Occasional Papers, No 35, November 2007, European Commission. ISBN 978-92-79-04693-3

This paper reviews the public pension schemes and the pension models used for the projections carried out by the Economic Policy Committee and the European Commission on age-related expenditure in 2005. The pension schemes described include any reforms that were enacted by mid-2005, even though implementation of the reforms would happen over a longer period. The paper contributes to the better comparability of the pension projections across the Member States and includes country-specific descriptions of the systems in use.

More titles…

- Guiding principles for product market and sector monitoring
- Main results of the 2007 fiscal notifications presented by the candidate countries
- 2006 economic and fiscal programmes of potential candidate countries

Country Focus series

Recent publications include:

The impact of fiscal policy in Hungary

By Julia Lendvai of DG ECFIN. Country Focus, Volume IV, Issue 11, November 2007, European Commission.

A study of the impact of government spending in Hungary over the period 1997 to 2005, using a value-at-risk model to identify fiscal shocks. The results show that expansionary spending is largely funded by government deficits and has a mixed impact on the private economy. Overall, increasing government expenditure is found to lead to a contraction of GDP. The author emphasises that successful expansionary policies depend crucially on the confidence the private sector has in the durability of the fiscal adjustment.

More titles…

- Managed vs free wage-setting in Finland and Estonia: optimising outcomes
- The business cycle in Poland: where do we stand?
- Long-term growth remains a challenge for Slovakia despite the current boom

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