



## European Recovery Programme

*By Jean Pisani-Ferry, André Sapir and Jakob von Weizsäcker*

### Memo Questions & Answers

#### **Why this policy brief?**

Growth forecasts are being revised downward by the week as both Europe and the US plunges into a serious recession in the aftermath of the financial crisis. In response to these exceptional economic circumstances, and in the light of the G20 Summit, which took place on 15 November 2008, the policy brief proposes and details a European Recovery Programme, consisting of a substantial and coordinated fiscal stimulus complemented by measures to strengthen fiscal sustainability.

#### **What are the forecasts for 2009?**

The financial crisis was followed quite rapidly by an economic downturn which is now putting more pressure on already weakened financial institutions and markets. Moreover, forecasts for 2009 are constantly being revised downwards. In fact, prospects of global growth are deteriorating. Drop in financial wealth, credit rationing and the rise in prices of capital and debt are the ingredients of what is likely to be the worse global recession since the Great Depression.

The authors outline that the growth prospects for the EU is at 0.2% of GDP in 2009 and 1.1% in 2010. This is projected to lead to a deterioration of the budgetary balance from -0.9 percent of GDP on average in 2007 to -2.6 percent in 2010 for the EU and from -0.6 percent to -2.0 percent in the euro area.

#### **Does Europe really need its own recovery plan?**

European leaders successfully put forward measures for market regulations during the G20 Summit, calling for “fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability”. But a European economic response has yet to be defined at home which is what this policy brief is advocating. If it does not act quickly, it will suffer severe economic damages and harm the internal market along the way.

#### **What does the European Recovery Programme entail?**

This policy brief proposes and details a European Recovery Programme, consisting of a substantial and coordinated fiscal stimulus complemented by measures to strengthen fiscal sustainability:

1. **Budgetary Boost:** harmonised VAT cut of 1% point across the EU along with targeted relief for countries with high deficits in order to reach 1% of GDP effective by 1 January 2009 and phased out in 2010.
2. **Reform Commitment:** compensation for deficits above three percent of GDP through sustainability-enhancing reforms.
3. **Enforcement:** correction of excessive deficits to be implemented as early as 2010 if reform commitment is broken.

**4. Prudent borrowing:** agreement by all euro-area countries not to borrow at more than 200 basis points above the lowest euro-area government bond yield.

**Why does it need to be coordinated at EU level?**

It is very important to ensure consistency and avoid free-riding behavior, otherwise National Governments might be tempted to engage in subsidy wars to support sectors in need and national champions. Experience has shown that in open economies, budgetary policy has only limited effects. Moreover, the more open the economy is, the more tempted governments are to free-ride and rely on neighbours' stimulus. The European Union should therefore give itself the means to protect the integrity of the internal market and reassure markets in the long-term.

**What is so attractive in this proposal?**

The timing. The recovery plan can be implemented immediately with short-term effects but with long-term commitments which will reassure markets across the board. The programme takes into account the difficult budgetary constraints some EU member states are facing- so that no one is left out - without losing track of the long-term commitments necessary to avoid making the same mistakes again. The authors have laid out a detailed proposal on how to maintain fiscal sustainability which could take the form of an adhoc agreement by member states and complement the Stability Growth Pact.

**Is this about reforming the Stability and Growth Pact?**

No, the aim of this policy brief is to give member states short-term flexibility in exchange of committing to long-term reforms which will then be certified by the European Commission.

In other words, to overcome deficits running too high in some EU member states, the proposed budgetary framework should be strengthened, complementing and reinforcing the Stability and Growth Pact.

**What effect will the VAT cut have? What are the estimated advantages?**

Cutting the VAT at European level has two distinctive advantages:

- it is a measure which can be implemented in a matter of weeks
- It will give a clear signal to the European public that the EU member states are moving ahead and in the same direction.

The authors acknowledge, however, that this is not the optimal tool, but believe that taking measures to improve sustainability will reassure markets.

**How can you ensure that the programme will be implemented?**

To make sure the programme can be realistically implemented, the authors recommend for the Commission to integrate the proposal into its Action Plan due to be presented on 26 November which will be discussed during the European Council meeting on 11-12 December 2008.