

The economic recovery plans

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Introduction

The financial crisis which began in 2007 worsened dramatically in the autumn of 2008, culminating in the most serious global economic recession of the post-war period. Moreover, the consequences of that recession are in turn threatening to aggravate the financial crisis. It is therefore vital to ward off that threat and ensure that this crisis does not turn into a protracted global depression.

The seriousness of the financial crisis and the economic recession and the scale of the accompanying risks prompted the economic policy makers to take swift and resolute action. Thus, governments and central banks took various measures to support the financial sector, which was in danger of collapse. Efforts were made to protect deposits and avert a looming credit crunch. In parallel with these measures, monetary policy was eased significantly throughout the world, a move made possible by the sharp decline in inflation expectations and risks. On the fiscal policy front, numerous countries devised measures in the form of economic recovery plans which, together with the automatic stabilisers, were intended to counteract falling demand.

This article looks at the economic recovery plans. The attempt to use fiscal measures to kick-start economic growth is laudable, but the question is whether that goal is actually being achieved. The first chapter aims to define a fiscal policy which could offer an appropriate response to the crisis, on the basis of the theoretical framework of fiscal activism and the findings of empirical studies on the subject. The second chapter describes the recent economic recovery plans of the United States and

those of the European Union and its Member States, including Belgium. The third chapter comments on these various plans. The article ends by drawing a number of conclusions.

1. Effectiveness and limits of an anticyclical fiscal policy

1.1 Theoretical background

A lively debate is in progress on the appropriate role of fiscal policy in steering the business cycle, principally during an economic recession phase. Recovery measures are mostly presented as a way of attenuating the unwelcome effects of a slowdown or an economic recession, such as rising unemployment. That is particularly true if those effects are not confined to purely cyclical phenomena but also impair the economy's growth potential. One example concerns the 'hysteresis' effects on unemployment, where the unemployed lose hope of finding a new job, and cyclical unemployment is liable to become structural. In such circumstances, governments may try to stimulate economic activity via both their expenditure and their revenue. Fiscal measures may provide a direct boost to economic growth via increased consumption or public investment, but they may also have an indirect effect, e.g. by augmenting household purchasing power via tax cuts or an increase in welfare benefits. The effectiveness and desirability of such demand management by the

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government on the basis of the theories of John Maynard Keynes call for a number of comments.

First, it is important for such recovery measures to be timely in their effects, otherwise their impact might only become apparent after the cyclical upturn and the measures would become procyclical. In reality, all kinds of delays may occur, originating in particular from the political decision-making process, not only at the stage of identifying the economic slowdown but also when the measures are implemented.

Second, measures to support demand must, by definition, be temporary and must be neutralised as soon as the economy picks up. Experience has also shown that, for policy makers, it is far more attractive to implement such recovery measures than to abolish them. There is therefore a possibility that “temporary” recovery measures may become permanent, causing the structural budget position to deteriorate.

Third, it is important that budget resources intended to stimulate the economy should be allocated correctly, and that recovery measures should be defined and established on the basis of objective criteria, taking account of general well-being. Nonetheless, it is hard to ensure that the measures cannot be distorted by various private interests and pressure groups. If that happens, the government measures become less effective.

In addition, the effectiveness of the recovery package is largely determined by the response of private economic agents. In that regard, various factors may undermine that effectiveness. Thus, the effectiveness of tax cuts or increases in household allowances may be diminished if, owing to the uncertainty surrounding their future financial situation, the households choose to set aside a large percentage of the resulting additional resources. Similarly, tax cuts for businesses do not necessarily cause firms to step up their investment, or recruit or retain more staff. In uncertain times, firms may prefer to devote the resulting additional resources to strengthening their balance sheet, especially if they face substantial excess capacity as a result of a sharp fall in demand. In the economic literature, this type of reaction – which may considerably impair the effectiveness of a fiscal stimulatory policy – is known as a “non-Keynesian effect”.

It must also be borne in mind that a deterioration in the budget situation and increased government borrowing exert upward pressure on interest rates and thus compromise the effectiveness of the recovery package. These inhibiting effects can be attenuated if the fiscal policy is accompanied by an accommodating monetary policy.

Finally, the degree of openness of the economy is an essential factor: if the import ratio is high, all other things being equal, the impact of a given fiscal measure on domestic activity growth will obviously be smaller than in the case of a low import ratio.

For these reasons, it is essential to assess which elements will determine the reactions of private economic agents to the fiscal stimuli. Apart from general confidence in the economy, the credibility of fiscal policy also plays a decisive role. Doubts over the sustainability of public finances may in fact render consumers and investors even more cautious, and lead to non-Keynesian reactions. The proportion of households and businesses facing constraints on liquidity or credit is another important factor. The greater that proportion – which in principle rises in a period of economic recession – the more likely it is that the tax incentives will trigger consumption and investment expenditure, reinforcing the effectiveness of fiscal activism.

The conclusion is therefore that the theoretical basis for the anticyclical fiscal policy is not clear cut. In any case, during an economic recession, a recovery package is not the obvious way of achieving the desired effects, as the effectiveness of the measures seems heavily dependent on the detailed recovery plan arrangements, and on circumstances such as the situation regarding public finances.

1.2 Empirical results for fiscal multipliers

There is also a huge volume of empirical literature on the effectiveness of an active fiscal policy designed to support demand. This often refers to what are known as the fiscal multipliers, which reflect the extent to which a given fiscal stimulus will boost the growth of activity.

However, these studies are not unanimous in their conclusions regarding both the scale of these multipliers and the relative effectiveness of the various measures concerning revenue and expenditure. In line with the theory, the empirical findings appear to depend largely on the exact circumstances, and often also on the model used to assess the results. They must therefore be interpreted with the greatest caution. Nonetheless, the empirical literature does permit a few tentative conclusions.

Although the empirical estimates of the fiscal multipliers vary widely in their results, ranging from (Keynesian) values of 1 or more to negative values, in most cases they are positive, implying that fiscal recovery measures are actually capable of providing a positive boost to economic growth. However, most of the studies do indicate fiscal

multipliers of less than 1, and in many cases the impact of a temporary stimulus on economic activity is very limited.

Moreover, the multipliers appear to diverge according to the type of stimuli considered. Many studies demonstrate that it is temporary increases in consumption and public investment that have the greatest positive and immediate impact on economic activity, although ordinarily that effect soon fades. Conversely, in the long term, a cut in public revenues seems to be more beneficial for economic growth than an increase in public expenditure.

Empirical studies also confirm that the scale of the liquidity and credit constraints plays a role in the effectiveness of a fiscal stimulatory policy. The greater the number of households and businesses facing such constraints, the higher the fiscal multipliers of tax cuts.

It also seems that the impact of recovery measures is smaller if the situation regarding public finances – generally estimated on the basis of the level of public debt or its growth – is deteriorating. This is because the recovery measures drive up interest rates, depressing private investment, and because households save more as a precaution in times of budget problems.

Finally, the fiscal multipliers clearly diverge from one country to another. Thus, the impact of the recovery package tends to be weaker the smaller and more open the economy, since a large part of the fiscal stimulus may be exported. Various studies observe smaller multipliers for developed economies than for developing economies, owing to greater liquidity constraints in the latter. In addition, studies at national level find that multipliers in the EU Member States are smaller than in the United States.

1.3 What fiscal policy in response to the crisis?

The theoretical considerations and empirical findings described above seem to suggest that fiscal activism is not very effective as a way of smoothing out normal cyclical fluctuations. But the crisis which battered the global economy in the autumn of 2008 cannot be viewed as a normal cyclical slowdown. Given the gravity of the economic situation and the scale of the associated risks, it seemed right to mobilise all possible resources to reverse this situation. In that context, fiscal policy does have a role to play.

Given that the recession could become protracted, it is irrelevant to argue that economic recovery plans always come too late. Moreover, owing to the recession more households and businesses could face liquidity or credit constraints than under more normal circumstances, and

that should augment the impact of the recovery measures. Finally, under the said circumstances, it is desirable to support economic activity in order to halt the negative spiral and curb the hysteresis effects on unemployment.

However, in order to succeed, economic recovery plans have to fulfil certain conditions.

First, the recovery plans must form part of a much wider package. In that regard, the absolute priority is to stabilise the financial system, without which it will in fact be impossible to achieve a recovery in the real economy. Moreover, fiscal stimuli are more effective if accompanied by a flexible monetary policy.

Second, recovery measures obviously need to be timely, temporary and targeted – the famous 3 Ts. Another requirement might be coordination: coordinated action is desirable because part of the fiscal stimulus is exported via an increase in imports, and is also needed to eliminate protectionist reflexes from national recovery plans. These conditions should be considered necessary for fiscal activism, but not sufficient to ensure its success.

Automatic stabilisers, such as the decline in tax revenues and the increase in unemployment benefits during an economic recession, always satisfy the 3 T criteria. In countries where, during a recession, relatively powerful automatic stabilisers already ensure a temporary and targeted economic recovery, the need to resort to fiscal activism – and the scope available for that purpose – is also less than in countries where the automatic stabilisers are relatively limited.

Third, wherever possible the recovery package should try to facilitate rather than complicate or delay essential structural reforms. Nevertheless, it is not always obvious how to reconcile such aims with other requirements. From that point of view, public investment appears to be the best option in terms of fiscal multipliers and strengthening of the economic growth potential, although in practice speedy implementation may prove difficult.

Finally, it is vital to dispel doubts about the long-term sustainability of public finances. In many European countries, including Belgium, that last condition is already imposing tight constraints on the scope for far-reaching recovery measures – which would impose a heavy burden on the budget. Combined with a rather unfavourable initial budget situation in some countries, the effect which the economic recession exerts on the budget position via relatively powerful economic stabilisers has seriously damaged the health of public finances in many countries. Consequently, there is a danger that it will become even

more problematic to finance the budgetary cost of population ageing.

In order to eradicate doubts about the sustainability of public finances, it is therefore important for the recovery measures to be largely temporary, and for the economic policy makers to highlight the prospect of reducing budget deficits and, preferably, eliminating them as soon as the economy reverts to a more normal growth path.

2. Description of the recovery plans in the United States and in Europe

This chapter reviews the various economic recovery plans as devised by the United States, and by the European Union and its Member States, including Belgium.⁽¹⁾ It concentrates more particularly on the planned increases in expenditure and tax cuts, since they have a direct effect on the general government budget balance. Conversely, this chapter devotes little or no attention to the relatively numerous measures taken to support the financial sector and the financial markets, and other measures which have no direct impact on the budget balance.

2.1 The US recovery plan

In addition to the initiatives taken by the Federal Reserve via its monetary policy instruments, the American government has implemented or approved a number of recovery and stabilisation plans in order to limit the impact of the financial crisis on the real economy and to support the sectors hit by this crisis.⁽²⁾

Thus, in February 2008 Congress approved the Economic Stimulus Act, a law comprising measures totalling 168 billion US dollars to support individuals, firms and the mortgage market.

In February 2009 the American Recovery and Reinvestment Act was passed in order to cushion the impact of the financial crisis on the real economy and to halt the slump in demand. This large-scale recovery plan aims to create or safeguard 3 to 4 million jobs – 90 p.c. of them in the private sector – via multiple fiscal stimulus measures.

(1) This article does not consider the plans adopted in other countries, even though their scale is sometimes considerable. For instance, in China, according to IMF data published in April 2009, discretionary measures relating to 2007 represented a cumulative budgetary cost amounting to 0.4 p.c. of GDP in 2008, 3.1 p.c. of GDP in 2009 and 2.7 p.c. of GDP in 2010. The corresponding figures for Russia are 0 p.c. of GDP in 2008, 4.1 p.c. of GDP in 2009 and 1.3 p.c. of GDP in 2010, and for Japan 0.3 p.c. of GDP in 2008, 2.4 p.c. of GDP in 2009 and 1.8 p.c. of GDP in 2010.

(2) The Emergency Economic Stabilization Act (October 2008) and the Financial Stability Plan (February 2009) include measures designed to restore liquidity and stability on the US financial markets and to recapitalise a number of financial institutions (and certain vehicle manufacturing groups).

TABLE 1 RECOVERY MEASURES IN THE UNITED STATES: AMERICAN RECOVERY AND REINVESTMENT ACT
(billions of US dollars, unless otherwise stated)

Tax cuts ⁽¹⁾	288
Tax cuts in favour of States and local authorities ⁽²⁾	144
Infrastructure and science	111
Protection for vulnerable groups	81
Health care	59
Education and training	53
Energy	43
Other	8
Total	787
<i>p.m. As a percentage of GDP</i>	<i>5.4</i>

Source: www.recovery.gov.

(1) Of which 15 billion US dollars for infrastructure and science, 61 billion for the protection of vulnerable groups, 25 billion for education and training and 22 billion for energy. Altogether, the funds allocated thus total 126 billion for infrastructure and science, 142 billion for the protection of vulnerable groups, 78 billion for education and training and 65 billion for energy.

(2) These tax reductions aim to prevent any cut-backs in expenditure on health care and education and tax increases on the part of States and local authorities.

This last plan implies a budgetary cost of 787 billion US dollars, or 5.4 p.c. of GDP. Almost 40 p.c. of the amount allocated to recovery measures corresponds to tax cuts, including a general reduction in personal income tax of 400 dollars per person. Just under 20 p.c. of this amount is to be allocated to aid for the States and local authorities. Finally, just over 40 p.c. will go on expenditure, and more particularly on social and federal programmes. These programmes focus mainly on infrastructure projects and science, protection for vulnerable groups, health care, education and training, and energy.

2.2 The European Economic Recovery Plan

A number of national governments in the EU had already announced economic recovery plans or had such plans in preparation, but it was on 26 November 2008 that the EC presented a European framework for the plans. The “European Economic Recovery Plan” was approved by the European Council on 11 and 12 December 2008. It provides a common framework for the implementation of an active fiscal policy designed to limit the scale of the recession, to stimulate demand and to restore confidence. This plan provides for a total fiscal stimulus of 200 billion euro – or around 1.5 p.c. of the EU’s GDP –, with

Member States contributing 170 billion euro in the form of fiscal measures, and the European Investment Bank providing 30 billion via increased lending.

The recovery plan does not propose any specific allocation of measures among the Member States. However, the EC stated that account should be taken of the initial situation of the various Member States, and of the fact that they did not all have the same fiscal room for manoeuvre.

According to the European Economic Recovery Plan, the proposed fiscal stimuli must be carefully designed and based on a number of principles.

First, the recovery measures must satisfy the 3 T criteria: they must be timely, temporary and targeted. According to the EC's interpretation, this last condition means that the recovery measures must target the source of the economic problem – unemployment, credit constraints facing households and businesses, and support for structural reforms – in order to maximise the stabilisation effect produced by limited budget resources.

Next, the recovery measures must combine instruments affecting both revenue and expenditure. However, the EC pointed out that increases in consumption and public investment generally had a greater influence on demand than tax cuts, since some consumers may prefer to set aside the amount saved from lower taxes. In that context the European Economic Recovery Plan draws up a list of measures which may provide a fiscal stimulus. Thus, expenditure may be increased, either by measures to support the households hardest hit by the crisis – such as an increase in benefits for low-income households or the unemployed, and a temporary extension of the unemployment benefit period – or by bringing forward investment projects which may be advantageous for SMEs or may support long-term political goals. Guarantees and subsidies in the form of loans may also help to alleviate the shortage of credit. Other possibilities include financial incentives to speed up the adjustment of economies facing long-term challenges, and more particularly, to promote energy efficiency. Reductions in taxes and social security contributions for both businesses and households may strengthen demand for labour and boost purchasing power. Finally, temporary reductions in the rate of VAT may support private consumption.

The fiscal stimuli also need to be accompanied by structural reforms within the broader context of the Lisbon strategy, which aims in particular to raise the employment rate and create a knowledge-based economy.

Finally, the recovery measures must fit into the framework defined by the Stability and Growth Pact, which lays down the rules of fiscal discipline to be respected by the EU Member States. The European Economic Recovery Plan provides for “judicious” application of that pact, ensuring the establishment of fiscal strategies with medium-term credibility. Thus, the existence of exceptional circumstances combining a financial crisis with a recession justifies the immediate implementation of a recovery plan, even if that may cause some Member States to exceed the deficit reference value of 3 p.c. of GDP. Member States were asked to submit an updated stability or convergence programme. That updating should clarify the measures to be adopted to compensate for the deterioration in the budget and guarantee the sustainability of public finances.

Regarding the excessive deficit procedure, the EC has to produce a report in all cases where the public deficit exceeds the reference value of 3 p.c. of GDP.⁽¹⁾ A deficit is called excessive if it fails to satisfy the following three conditions simultaneously: the excess must be temporary, limited, and due to exceptional circumstances. A correction procedure is then launched in accordance with the rules laid down by the pact. The EC has stated that, although the current circumstances are clearly exceptional, it is unlikely that the deficits expected in excess of the reference value in many Member States can satisfy the other two conditions, so that the pact offers little scope for avoiding the launch of the excessive deficit procedure against the Member States concerned.

Conversely, the EC drew attention to the great flexibility which has existed since the 2005 reform in regard to the implementation of this procedure, especially concerning the time allowed and the structural budget effort required to correct the excessive deficit. Thus, in specific circumstances, the period is set at two years – instead of one year – following identification of the excessive deficit, and the EC has drawn attention to precedents in which even more flexible periods applied. Moreover, that period may be extended in the event of unexpected economic developments which have a very adverse effect on public finances. Finally, the EC stated that under the pact the Ecofin Council calls on Member States with an excessive public deficit to make an annual structural budget effort representing at least 0.5 p.c. of GDP, which is regarded as the reference value, and that the scale of the budget effort required can therefore be adjusted in line with exceptional circumstances.

(1) Under Article 104 § 3 of the Treaty establishing the European Community.

Turning to the medium-term goals of fiscal policy, the EC states that, as potential growth will probably be revised downwards, the same will apply to the structural budget balances. In that context, the deadline for achieving the medium-term objectives specific to each country could also be reviewed case by case.

2.3 The recovery plans of the EU Member States

2.3.1 General

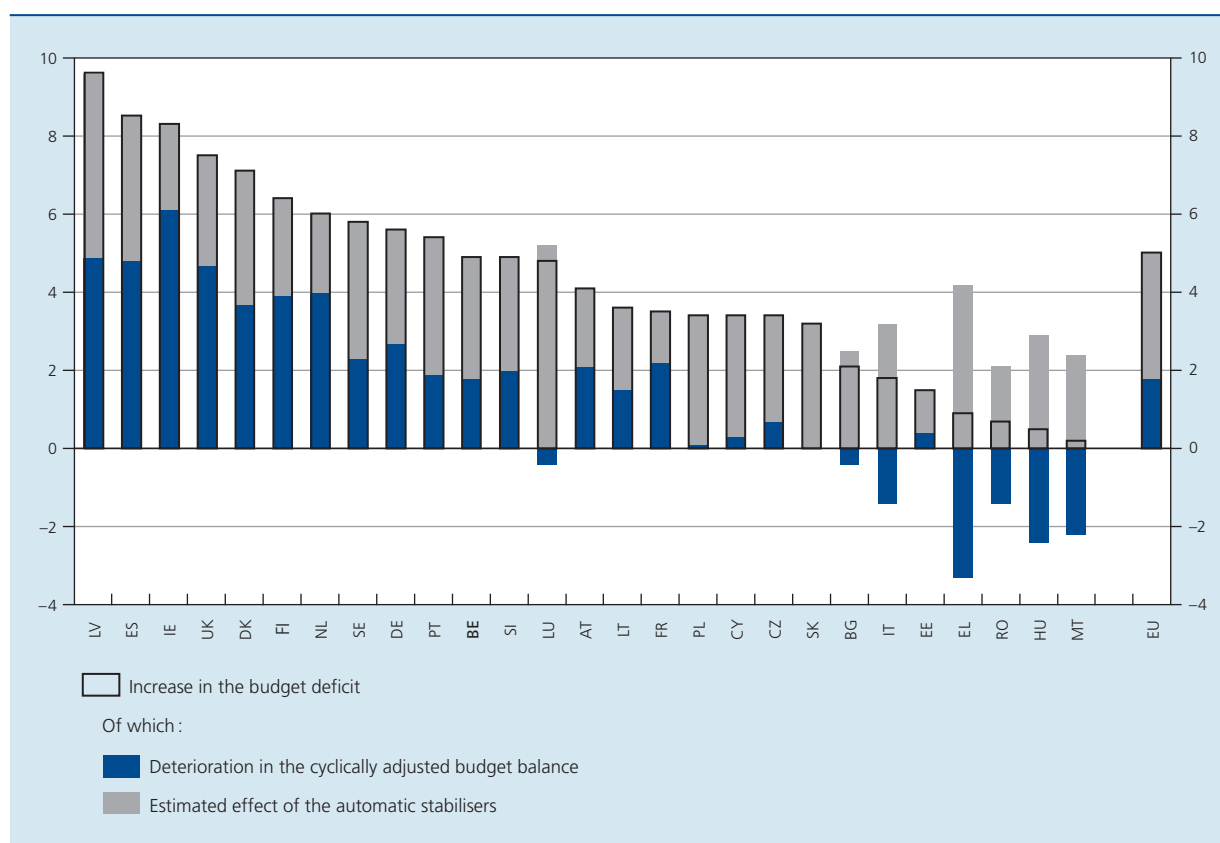
Total fiscal support for economic activity

In line with the European Economic Recovery Plan, the governments of most EU Member States took measures to stimulate economic activity. The latest information from the EC indicates that the total fiscal policy support for economic activity in the EU amounts to around 5 p.c. of GDP in 2009 and 2010 together.

Only part of this support is attributable to discretionary recovery measures. These comprise all measures adopted or announced since the autumn of 2008 which may be regarded as a fiscal response to the economic recession. Thus, the impact on the budget balance of the measures approved or announced by EU Member States comes to over 135 billion euro (1.1 p.c. of GDP) for the EU as a whole in 2009. That impact will decline to 90 billion (0.7 p.c. of GDP) in 2010. It is possible to obtain an approximation of this discretionary component via the change in the cyclically adjusted budget balance, which is often used as an indicator of the fiscal policy stance.⁽¹⁾

⁽¹⁾ The change in the cyclically adjusted budget balance does not necessarily tally with the scale of the fiscal measures designed to stimulate economic activity, as laid down in the recovery plans. That discrepancy is due partly to discretionary measures which are not recorded in the recovery plans, and partly to technical factors relating to the calculation of the cyclically adjusted budget balance.

CHART 1 TOTAL FISCAL SUPPORT FOR ECONOMIC ACTIVITY⁽¹⁾
(percentages of GDP, cumulative effect over 2009 and 2010)



Source: EC.

⁽¹⁾ Excluding the financial sector support measures (such as recapitalisations and provision of liquidity) and guarantees granted to the private sector.

In addition, the budget's automatic reaction to the economic recession should play a considerable role in Europe. More specifically, the effect of the automatic stabilisers over 2009 and 2010 is estimated at around 3.2 p.c. of GDP. That is an average figure, since the effect of the automatic stabilisers varies greatly from one country to another, given the divergences in terms of factors such as the tax burden and the progress of the economic cycle. This figure should also be treated with caution since the difficulties which already arise under ordinary circumstances in distinguishing between automatic fluctuations in the budget balance and discretionary adjustments are heightened by the exceptional character of the current situation.

In the EU, the total fiscal support for economic activity is likely to cause the budget balance to deteriorate by around 5 percentage points, creating a deficit of over 7 p.c. of GDP in 2010. In the euro area, the budget balance is set to deteriorate by 4.5 percentage points, producing a deficit of 6.5 p.c. of GDP in 2010.

Measures in favour of the financial sector are disregarded in the EC's estimate of total fiscal support mentioned above, although they will obviously play a vital role in overcoming the current crisis. Moreover, the EU Member States have also taken a series of measures which have no impact on the general government budget balance. This mainly concerns loans and capital injections for non-financial corporations, the early reimbursement of VAT, and the increase in investments by public enterprises.

Comparison of the various fiscal policy responses in terms of both the scale and the content of the total fiscal support reveals notable differences between EU Member States. That finding is also true of the recovery plans. The following section concentrates on the scale and content of those plans. Differences concerning the action of the automatic stabilisers are not examined. However, it should be noted that the normal action of these stabilisers is an essential element of the total fiscal support for economic activity. As already stated, in most EU Member States the contribution of the automatic stabilisers exceeds that of the discretionary measures contained in the economic recovery plans.

Scale of the recovery plans

The scale of the recovery plans as identified by the EC varies greatly from one EU Member State to another. In Spain, Austria, Finland, Malta, Germany and the United Kingdom, the scale of the recovery plans for 2009 exceeds the norm of 1.2 p.c. of GDP proposed by the EC. In contrast, Luxembourg, the Czech Republic, Poland, France and the Netherlands are very close to the European average of 1 p.c. of GDP. In Belgium, the recovery measures look limited in comparison with those adopted by all these countries, since they amount to only 0.5 and 0.4 p.c. of GDP respectively in 2009 and 2010. However, in a number of EU Member States the measures adopted have had little or no impact on the budget. That is true, for instance, of the Baltic States and of several east European countries – Bulgaria, Hungary and Romania –, and of some southern European countries such as Cyprus, Italy and Greece.

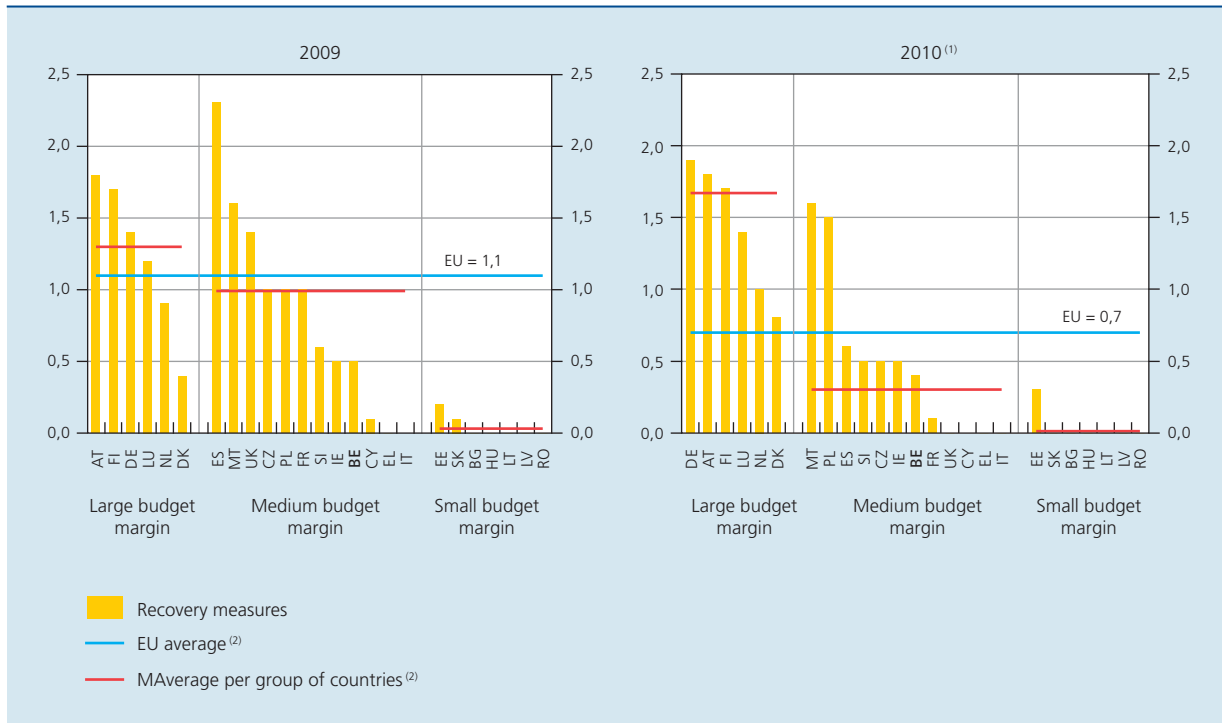
The differences in terms of the scale of the EU Member States' recovery plans are in line with the European Economic Recovery Plan's call for the initial budget position of each country to be taken into account in devising these plans. Moreover, the EC has tried to examine the extent to which the EU Member States had in fact taken that point into account. For that purpose, it compared the scale of the national recovery plans to a budget margin indicator developed by its staff. That indicator refers to a country's capacity to finance the desired fiscal programmes in the short, medium and long term, and to honour its creditors without jeopardising macroeconomic stability and the sustainability of public finances.⁽¹⁾

On the basis of that indicator, the EC divided the EU Member States into three groups according to whether their budget room for manoeuvre was large, medium or small. In view of the highly complicated method of calculating this indicator, the results must be interpreted with caution. Belgium belongs to the group of countries with medium room for manoeuvre.

In general, the Member States with greater budget room for manoeuvre seem to have adopted more recovery measures than those which have less scope. More specifically, the measures adopted by countries with ample budget room for manoeuvre represent, on average 1.3 p.c. of GDP in 2009 and 1.7 p.c. in 2010, whereas the corresponding figures for those years in countries with average budget room for manoeuvre are around 1 and 0.2 p.c. of GDP respectively. On the other hand, countries with limited budget room for manoeuvre have made little or no use of recovery measures.

(1) The indicator is based on six variables, namely: gross public debt, the implicit debt of the financial sector – calculated on the basis of the outstanding domestic debt of the private sector and a risk factor –, the potential medium-term adverse impact on revenues generated by corporation tax and capital taxes, the current balance, non-discretionary expenditure – essentially interest charges and pensions – and a sustainability indicator.

CHART 2 SCALE OF THE RECOVERY PLANS
(percentages of GDP)



Source : EC.

(1) The figures indicate the change between 2008 and 2010. They therefore take account of permanent measures which came into force in 2009 and the net effect of measures planned for 2010.

(2) Weighted average.

Content of the recovery plans

The recovery plans adopted by the EU Member States comprise a range of measures. Over half of the EU Member States have reduced the fiscal and parafiscal burden on labour, measures which are likely to have a major impact on the budget in a number of countries. Under half of the Member States have adopted measures concerning taxes on corporate profits. VAT cuts are less common: the United Kingdom is the only country to have made a substantial general, but temporary, reduction in VAT. Cyprus, Finland, Austria and Belgium resorted to sectoral cuts in VAT. Those cuts concerned the following branches of activity respectively: tourism, food, pharmaceuticals and construction. Most of the EU Member States endeavoured to stimulate investments in public infrastructure. Rather than new initiatives, most of these measures concern infrastructure projects which were already planned and have been brought forward. Over half of the EU Member States have adjusted social benefits (pensions, family allowances and unemployment benefits). In the majority of countries, these measures have little impact on the budget. Finally, all Member States have

adopted other measures aimed, in particular, at facilitating access to credit, reinforcing the liquidity position of firms, stimulating private investment in R&D and energy efficiency, assisting certain specific sectors (such as the car industry and the property market), and establishing an active labour market policy.

The recovery measures taken at the scale of the EU and the euro area are evenly balanced between expenditure and revenue. Of the total discretionary recovery measures, which amount to 1.1 p.c. of GDP in 2009, just under half (0.5 p.c. of GDP) concern expenditure while just over half (0.6 p.c. of GDP) concern revenue. In most of the EU Member States, there is a balanced mix of measures affecting expenditure and revenue. However, a number of countries, namely Finland, the Netherlands, Luxembourg, Austria, the United Kingdom and Poland, have focused most of their measures on revenues. Conversely, the opposite is true for Cyprus, Estonia, Malta, Portugal and Slovenia.

TABLE 2 COMPOSITION OF THE RECOVERY MEASURES⁽¹⁾
(2009)

	AT	BE	BG	CY	CZ	DE	DK	EE	EL	ES	FI	FR	HU	IE
Levies on labour	X	x	x		x	X	X			X	X	x	x	
Corporation tax	x				x	X			x	X		x		
VAT	x	x		x							X			
Public infrastructure ⁽²⁾	x	x	x	x	x	X	X	x		X	x	X	x	x
Social benefits	x	x	x	x		x			x	x		x		X
Other	x	x	x	X	x	X	x	x	x	X	x	x	x	x

	IT	LT	LU	LV	MT	NL	PL	PT	RO	SE	SI	SK	UK
Levies on labour	X		X	x	x	x		x	x	X		x	
Corporation tax			X			x	X	x		X	x		
VAT													X
Public infrastructure ⁽²⁾	x	x	X		x	x	X	x	X	x		x	x
Social benefits	x		X	x			x	x	x				x
Other	x	x	X	x	x	x	x	x	x	X	x	x	x

Source: EC.

(1) This table was produced using an EC database which records various recovery measures adopted by EU countries. It does not include some more recent measures, such as the reduction in VAT in the hotel and catering trade in France.

(2) A minority of measures concerning the public infrastructure consist of new initiatives. In other words, most of them relate to projects which had already been planned and were brought forward.

X Big impact on the budget (≥ 0.2 p.c. of GDP).

x Small or unspecified impact on the budget.

Effect of the recovery plans on economic growth

It is uncertain how the recovery plans will affect economic growth, as estimating the fiscal multipliers entails making a number of strong assumptions. On the basis of its economic model, Quest III, and assuming a serious shortage of liquidity for households, the EC estimated that the European recovery measures would contribute 0.8 percentage point to GDP growth in 2009 and 0.3 percentage point in 2010.⁽¹⁾

2.3.2 Recovery measures adopted by certain EU Member States

This section examines in more detail the recovery measures adopted by countries bordering Belgium. It also comments on the recovery plans set up in the United Kingdom and Spain, as they are relatively substantial in scale.

(1) These figures are based on discretionary stimuli amounting to 1 p.c. of GDP in 2009 and 0.5 p.c. of GDP in 2010, corresponding overall to the scale of the European recovery plans.

Germany

Germany has the most ambitious recovery plan of all the EU Member States, in terms of both percentage of GDP except Austria – and billions of euro. The EC estimated the budgetary cost at around 3.3 p.c. of GDP over 2009 and 2010 together. More specifically, the impact on the budget is assessed at 1.4 p.c. of GDP in 2009, rising to 1.9 p.c. of GDP in 2010.

This discretionary support largely takes the form of a reduction in the charges imposed on labour. There are also plans for a fundamental reform of corporation tax, and substantial public investment in infrastructure has been announced. In addition, a 2,500 euro allowance is granted in cases where a car over 9 years old is replaced by a more ecological vehicle. Only one-third of the purchases resulting from this measure concern German-made cars, so that there are significant spill-over effects for foreign car makers. The other measures include in particular reinforcement of the employment activation policy, extension of the temporary lay-offs system, a structural, one-off increase in family allowances, reintroduction of more

flexible rules on depreciation for businesses to encourage them to invest, reinstatement of the tax allowance for commuters, and a steeper increase in pensions and social benefits in the context of rising unemployment. Finally, there is the implementation of a programme of loans and guarantees for businesses amounting to 100 billion euro, although this measure has no impact on the general government budget balance.

France

The French recovery plan is less extensive than the German plan. The EC estimates its budget impact at 0.9 p.c. of GDP, namely 0.8 p.c. of GDP in 2009 and 0.1 p.c. in 2010.

The plan boosts the purchasing power of low-income households by payment of a solidarity bonus of 200 euro per household, and by tax cuts and tax exemption. In contrast to the German recovery plan, a reduction in charges on labour is not a key component of the French recovery plan. Although the employers' contributions payable by SMEs recruiting unemployed persons have been reduced, the budget impact of this measure is small. In order to support the labour market, the employment activation policy is also being reinforced. In addition, the French economy is being revitalised by substantial investment in infrastructure projects, such as the renovation of university campuses. Business investment is also being encouraged by tax exemptions. Furthermore, there is sectoral support for the car industry, in the form of a 1,000 euro allowance in cases where an old car is replaced by a new one, and substantial loans for car makers, and support for the property sector by the doubling of the amount on which a zero-rate loan can be arranged for the purchase of a new home and by increased finance for housing construction. Finally, aid is being granted to French firms via numerous measures geared to liquidity, and a programme intended to support lending to SMEs has been set up, but these measures have no direct impact on the general government budget balance.

Netherlands

The EC estimates the overall budget cost of the Dutch recovery plan at 1.9 p.c. of GDP in 2009 and 2010. The discretionary support is put at around 0.9 p.c. of GDP in 2009 and 1 p.c. of GDP in 2010.

The measures mainly affect public revenues. For instance, there are measures concerning corporation tax, particularly via an adjustment to the depreciation rules, and measures concerning social security contributions and personal income tax. It was also decided to cancel the planned 1 percentage point increase in VAT and to

abolish the tax on airline tickets. In addition, household purchasing power is being boosted by the reduction in unemployment insurance contributions. There is also sectoral support for the social housing market and support for the car industry, via payment of an allowance for the replacement of an old vehicle. In addition, specific measures to combat unemployment have been adopted, such as the introduction of a system of temporary lay-offs. Investments in public infrastructure have also been announced, mainly the acceleration of projects already planned. Finally, there are government guarantees to encourage lending to SMEs.

Luxembourg

The recovery plan adopted by Luxembourg comprises measures amounting to 2.6 p.c. of GDP. The impact on the budget is estimated at 1.2 p.c. of GDP in 2009 and 1.4 p.c. in 2010.

The recovery measures consist largely of tax cuts and a significant increase in public investment. In order to support household purchasing power, the personal income tax scales have been index-linked, pensions have been increased by 2 p.c., and there are plans for a reform which will extend the tax credit for dependent children. Corporation tax has been cut from 22 to 21 p.c., and the tax on capital increases has been abolished. In addition, struggling firms may qualify for a special support programme and SMEs may be eligible for increased subsidies. The Luxembourg recovery plan also provides for labour market support via an incentive to resort to temporary lay-offs, with refund of the employer's contribution to unemployment benefits, extension of the period covered and increased benefits for workers who attend training. Finally, there is a package of "green" measures, designed to promote environment-friendly cars and eco-energy consumption.

United Kingdom

The EC estimates the impact of the United Kingdom's recovery plan at 1.4 p.c. of GDP. All the impact on the budget will be felt in 2009.

The main measure is the temporary reduction in the rate of VAT from 17.5 to 15 p.c. in 2009. Other measures include the acceleration of public investment in infrastructure and a one-off tax reduction of 130 pounds sterling per person in 2009, in addition to the £600 granted in May 2008. There are also some measures to reinforce the active employment policy, support for the residential property market and an increase in family allowances and pensions linked to prosperity. By analogy with the

recovery plans adopted in Germany and France, there is a £2,000 allowance for the purchase of a new car provided it replaces an old vehicle. Finally, a number of measures also aim to support lending to small businesses and to the car industry.

Spain

Like Germany, Spain has set up a relatively ambitious recovery plan compared to the other EU Member States. The EC considers that the Spanish recovery measures will have a budgetary cost of 2.9 p.c. of GDP in 2009 and 2010. Most of that will be felt in 2009, at 2.3 p.c. of GDP. In 2010, the budgetary impact of the Spanish recovery plan will drop to 0.6 p.c. of GDP.

A substantial part of the fiscal stimulus concerns investment in public infrastructure projects. A number of fiscal measures have also been adopted, such as a one-off, significant tax reduction of 400 euro per taxpayer, and the abolition of the wealth tax. In addition, households struggling to repay their mortgage loan are being granted guarantees. The car industry is also receiving specific aid. Moreover, to reduce unemployment employers are being granted exemption from social security contributions when taking on new employees. Finally, businesses, and especially SMEs, are receiving support in the form of loans and early reimbursement of VAT.

2.4 The Belgian recovery plan

Following the European Economic Recovery Plan, the federal government presented the broad outline of the Belgian recovery plan on 11 December 2008. In addition, the regions announced supplementary recovery measures.

The budgetary measures taken by the federal government to revive economic activity aim mainly to breathe new life into firms, to boost purchasing power and to safeguard jobs. The measures leading to the conclusion of the central agreement for 2009–2010 were incorporated in the recovery plan, which also aims to strengthen sustainable socio-economic leverage and investment in the environmental sphere. However, the budget resources earmarked for this last item are very limited. The budget expenditure of the regions is estimated to increase by only around 0.1 p.c. of GDP in 2009, as a result of the acceleration of investment projects already planned.

The effect on the budget balances of the whole series of discretionary measures comes to 0.9 p.c. of GDP in both 2009 and 2010.⁽¹⁾ It essentially covers measures which had already been adopted, in particular increases in social

benefits and an extension of the payroll tax reductions granted by the federal and Flemish governments. The measures taken under the federal and regional recovery plans come to 0.5 p.c. of GDP in 2009 and 0.4 p.c. in 2010.

The main recurrent budgetary costs associated with the supplementary recovery measures are due to the extension of the payroll tax reductions for firms, amounting to 482 million euro in 2009 and 1.1 billion in 2010. Thus, the reductions in charges on shift work and night work have been extended with effect from 1 June 2009. The number of overtime hours qualifying for exemption has also been increased, and the general reduction in payroll tax was extended in June 2009, and will be extended again in January 2010. Finally, the percentage of the payroll tax reduction applicable to researchers has been increased.

In addition, to counteract the repercussions of the crisis, the government adopted a series of specific measures which also have a permanent impact on the budget balance. For instance, the purchasing power of workers who have been temporarily laid off was boosted by a simultaneous increase in both the unemployment benefit reimbursement rates and the calculation ceiling. Moreover, the tax discrimination affecting married persons who are temporarily laid off has been eliminated, and subject to certain conditions, it is now easier for agency workers to claim benefits.

The recovery plans include only a small number of measures having a temporary impact on the budget balance. The federal government and the regions are trying to speed up the rate of their own investments. Also, the rate of VAT on the construction of new family housing has been cut from 21 to 6 p.c. on the first 50,000 euro tranche. The VAT rate has also been cut from 12 to 6 p.c. for the construction of public social housing. Finally, a one-off reduction of 30 euro on electricity bills has been granted to all households in 2009, costing the government an estimated 135 million euro.

The above measures form just part of the response by the federal and regional governments to the crisis. The federal government has in fact also provided support for the financial sector. In addition, it has adopted considerable measures to preserve the liquidity position of businesses and self-employed persons, e.g. by postponing the dates for payment of VAT, social contributions and payroll tax,

(1) The federal government also included in the recovery plan the effect of the indexation of personal income tax scales for 2009 (costing 1.2 billion euro). According to the methodology used by the Bank and by the EC, this is not regarded as a measure (though conversely, the non-indexation might be regarded as such). Its effect is therefore disregarded here.

TABLE 3 MAIN RECOVERY MEASURES IN BELGIUM⁽¹⁾
(millions of euro, change compared to 2008)

	2009	2010
Permanent measures	1,869	2,821
Measures already adopted	1,242	1,570
Payroll tax reductions ⁽²⁾	482	1,115
Increase in temporary lay-off benefits ...	100	103
Other	45	33
Temporary measures	1,140	153
Reduced rate of VAT in construction ...	300	0
Measures adopted by the regions	150	0
Acceleration of public investment	146	153
Reduction in electricity bills	165	0
Other	379	0
Total recovery measures	3,009	2,974
<i>p.m. As a percentage of GDP</i>	<i>0.9</i>	<i>0.9</i>

Sources: FPS Finance, budget documents.

(1) This only concerns measures having a direct effect on the general government budget balance.

(2) For shift work and night work, overtime and general reduction.

or by early reimbursement of VAT. Moreover, the regional plans place a large volume of funds at the disposal of non-financial corporations via regional investment companies. Nonetheless, taken together, these measures do not in principle imply any associated direct effect on the overall balance of general government.

3. Comments on the recovery plans

This chapter sets out some general thoughts on the economic recovery plans. It focuses first on the differences between the United States and Europe, and then examines the extent to which the European recovery measures satisfy the 3 Ts. Finally, it draws attention to the scale of the risks associated with the current wave of fiscal activism.

Differences between the United States and Europe

The US economic recovery plan is far more extensive than that of the EU. In specific terms, the budgetary cost of the American plan cumulated over 2009 and 2010 is estimated at 5.4 p.c. of GDP, while the European plan is expected to cost only 1.8 p.c. of GDP. However, these figures do not provide an accurate picture of the total

fiscal support in the two economies. For that purpose it is necessary to take account of the differences in terms of automatic stabilisers. In the EU, the budgetary support via the economic stabilisers is put at 3.2 p.c. of GDP, representing considerably more than the support provided via the recovery plans. In the United States, the stabilisers play a much more modest role, as the fiscal pressure is less there. Moreover, the absence of a strong social security safety net is a powerful argument in favour of a stronger fiscal stimulus in the United States. Also, past experience has shown that in the United States there is a culture of large-scale fiscal intervention in times of crisis, at least to a much greater extent than in Europe.

Timely, temporary and targeted?

It is difficult to judge whether the European recovery plans are sufficiently timely. All things considered, the government response has been relatively swift. Admittedly, there was some delay between the start of the economic crisis and its recognition, and between the decision on the recovery plans and their eventual implementation, but those delays were more or less inevitable. Past experience indicates that serious financial crises are often accompanied by protracted economic recessions. If the current recession also proves persistent, the measures will have been taken in good time, or at least, they will not be procyclical. The measures concerning investments seem to be geared mainly towards speeding up projects which have already been planned, rather than new investments. In Belgium, the measures which have the greatest impact on the budget balance, namely the reduction in payroll tax and the adjustment in line with prosperity, were not implemented until the second half of 2009. The temporary measures and the injection of liquidity were implemented promptly and could make a very effective contribution towards limiting the impact of adverse economic growth and helping viable companies faced with liquidity problems to get through the most difficult period.

The recovery plans of the various EU Member States are not all temporary. While those of some countries, such as the United Kingdom, are genuinely temporary, that is barely true – if at all – in other countries. Belgium belongs to this last category of countries. The recovery measures there are very largely permanent, mainly on account of the measures taken under the central agreement.

Finally, it is hard to assess the extent to which the interventions are targeted, notably because the criterion in question is vague. Be that as it may, a broad range of measures have been adopted. In Belgium, the measures appear to be partly targeted, e.g. in the case of those combating unemployment, providing financial resources

for firms and households facing liquidity problems, and stimulating structural reforms. Nonetheless, it should be noted that only a very small number of measures concern public investment, in particular because the federal government no longer has any substantial powers in that area. The major part of the cost of the plan directly benefits households and businesses as a whole, in the hope that this will give them more scope for consumption and investment. However, in an adverse economic period when the confidence of consumers and producers is weak, it is likely that a substantial proportion of these resources will be held as savings, and consequently not allocated to consumption or investment.

Risks associated with the current wave of fiscal activism

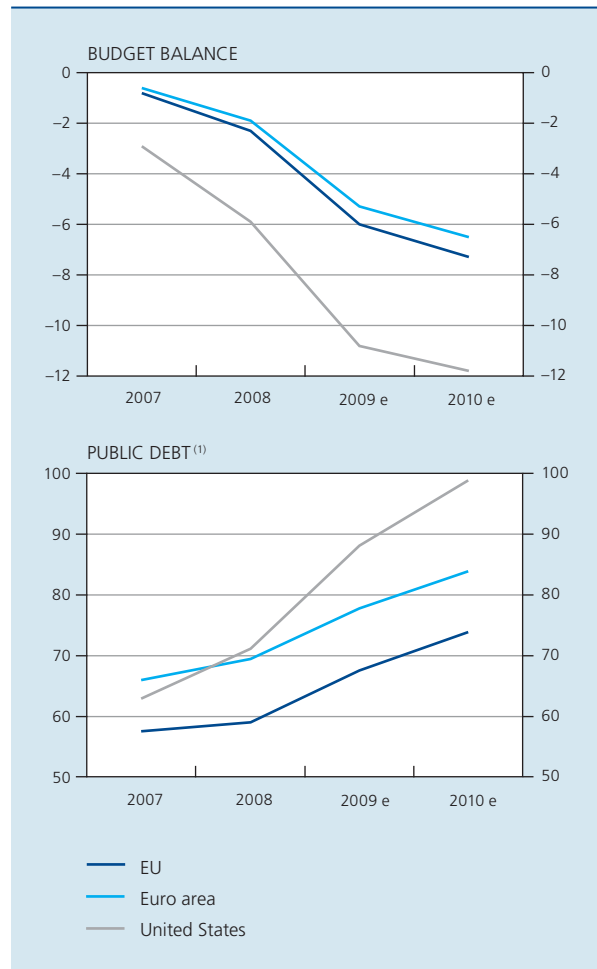
In recent decades a consensus has emerged whereby sound and sustainable public finances are one of the keystones of a culture of stability geared to sustainable long-term growth. In the EU, and more particularly in the euro area, a responsible fiscal policy is in principle imposed by the fiscal rules of the stability and growth pact. From that perspective, it should probably be pointed out that, since the introduction of the euro, some countries have not always adhered strictly to those rules, and have not taken sufficient advantage of favourable periods in previous years to achieve a structural improvement in their fiscal policy.

The wave of fiscal activism born of the economic and financial crisis is not without its risks. According to the latest EC estimate, as a result of the crisis the EU's budget deficit is expected to reach 7.3 p.c. of GDP in 2010, with a debt ratio of 73.9 p.c. of GDP in that year. In the euro area, the public deficit is put at 6.5 p.c. of GDP in 2010, while the debt ratio will climb to 83.9 p.c. of GDP. According to the OECD, the public deficit in the United States is likely to reach 10.8 p.c. of GDP in 2009 and 11.8 p.c. in 2010, driving up the debt ratio to almost 100 p.c. In view of the scale of the public deficits, the public debt is liable to expand considerably in the ensuing years.

The challenge which all the national governments must address concerns finding the right balance between, on the one hand, the need to revive the economy in the short term and the desire to achieve that by adopting fiscal measures, and on the other hand, the sustainability of public finances. In that regard, it must be remembered that in the coming years many countries will face the impact of population ageing on public finances.

That said, it is vital to dispel doubts about the long-term sustainability of public finances, especially as they thwart the desired effect of the recovery plans. Otherwise, non-Keynesian effects could emerge – in which case the main

CHART 3 PUBLIC FINANCE PROJECTIONS
(percentages of GDP)



Sources: EC, OECD.
(1) Consolidated gross public debt.

effect of the fiscal stimulus would be to drive up the savings ratio without boosting expenditure – and there could be a steep increase in interest rate spreads, and hence interest charges.

It is therefore vital for the recovery measures to be temporary as far as possible. It is also crucial that economic policy makers should emphasise the prospect of budget deficits being radically reduced, if not eliminated, as soon as the economy reverts to a more normal growth path.

In that connection, it should be stressed that, in a report on the European Economic Recovery Plan, submitted to the European Council on 18 and 19 June 2009, the Ecofin Council estimated on the basis of the economic and budgetary forecasts that new fiscal stimuli were not necessary and that the focus should be moved towards fiscal consolidation, as the economic recovery strengthens.

Conclusion

The economic recovery plans are a key element of the wide range of measures adopted by the economic policy makers worldwide in response to the financial crisis and the economic recession. The aim is of course laudable, but is it really achievable? While the recovery measures may indeed attenuate the economic recession in the short term, their effect is uncertain and could be relatively limited. The recovery plans cannot have the optimum short-term impact on economic growth unless certain conditions are met. An essential condition is that doubts over the long-term sustainability of public finances must be dispelled.

Combined with an initial budget position which is already weak in some countries, however, the economic recovery plans and the effect which the economic recession is exerting on the budget position via the relatively powerful automatic stabilisers have seriously impaired the health of public finances in a good many countries. It therefore seems that most European countries, including Belgium, no longer have any scope to adopt effective additional recovery measures. Conversely, there is now a need for clear and reliable strategies heralding a return to sound and sustainable public finances.

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