No 13 April 2009

# EUROPEAN ECONOMY news

ISSN 1830-5180

## Europe: global leadership for troubled times



Magazine of the Directorate-General for Economic and Financial Affairs

EUROPEAN COMMISSION

Economic and Financial Affairs
DIRECTORATE-GENERAL

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# Editorial

Marco Buti

Dear Reader

Welcome to this edition of *European Economy News*. As the full extent and effects of the global financial crisis become clearer, the EU and its Member States have taken decisive action to lay the groundwork for a return to sustained economic growth.

Importantly, they have done so under the existing framework for coordinated economic policy-making. At the Economic and Financial Affairs Council meeting on 10 March, the EU's finance ministers recommended that even in the current difficult situation, the rules of the Stability and Growth Pact continue to apply. The ministers also adopted a report on the economic and employment policies of the Member States within the context of the European Economic Recovery Plan.

This message of coordination was taken up at the European Council meeting on 19 and 20 March, where Member States affirmed that implementation of the recovery plan is progressing well. The Council set out the EU's position for the recent G20 summit in London, with reshaping the global financial system and rebuilding confidence as the main priorities. The EU's position was largely reflected in the final communiqué.

A Europe whose strength lies in unity is also emphasised by a DG ECFIN report on the economic effects of the addition of 12 new Member States over the past five years. The report leaves no doubt that the EU as a whole has gained from this fifth wave of enlargement. United in restoring Europe's employment and economic growth, and with a stronger voice on the world stage, a larger EU is better positioned to address the global financial crisis through a common strategy.

These events set the tone of the EU's contribution to the debate on international governance of the financial sector and the roadmap for global economic recovery.

Marco Buti

Director-General, Economic and Financial Affairs DG

# What's new

## SME Finance Day Madrid

Commissioner Almunia topped a prestigious list of speakers at the SME Finance Day held at the EU Representation in Madrid on 23 February, where the Competitiveness and Innovation Programme (CIP) financial instruments were explained to an audience of bankers, journalists, and members of the Enterprise Europe Network, who will promote the initiative to SMEs in their regions. Finance Days are being organised in all European capitals during 2008-2010 and are a joint initiative of DG ECFIN and DG Enterprise and Industry. They aim to raise awareness about the different sources and forms of finance available to SMEs for growing and developing their businesses. SMEs can find out if there is a Financial Intermediary already operating in their country at **www.access2finance.eu**. Further details of the programme can be found at **www.sme-finance-day.eu**


## Eurocompetition: winning poster

As part of the celebrations for the 10th anniversary of Economic and Monetary Union, the European Schoolnet organised a poster design competition, on behalf of DG ECFIN, for schoolchildren aged 10-14 across Europe. The winning design was announced in March and the 14-year-old designer – Viktória Ševcová from Ruzomberok in Slovakia – received her prize during a visit to Brussels and the European institutions. "I am impressed by the diversity of nationalities in this city. I like it so much here in Brussels that I would love to stay longer," said Viktória. Fifteen national finalists were also selected.

## Celebrating significant milestones

A conference in Prague on 2 March was organised by the Czech Presidency to celebrate the 5th anniversary of the biggest EU enlargement to date. Speakers reviewed its effects on economic and labour market developments in both the old and the new Member States. In his keynote address, the Prime Minister of the Czech Republic, Mirek Topolánek, described the 2004 enlargement as breaching for the first time the lines of the former iron curtain. Commissioner Joaquín Almunia expressed understanding for the hopes and aspirations of the new Member States from the east. Higher growth and trade and improving living standards are clear benefits for them, he said, while old Member States have benefited from new export and investment markets.

## Parliament adopts recovery plan report

Meeting on 11 March, the European Parliament adopted a report on the European Economic Recovery Plan prepared by MEP Elisa Ferreira which stresses the need for coordinated action between the Member States and makes a series of recommendations for increasing the fiscal stimulus in the EU, fighting tax havens, and for more effective regulatory and supervisory structures. Speaking to the Parliament, President Barroso said that the Ferreira report would provide important input to the March European Council, stressing that, "Europe has to find its strength in cohesion and practical solidarity."
**www.europarl.europa.eu**

## An EU foreign economic policy?

On 6 April, DG ECFIN organised a conference in Brussels entitled 'Towards a European foreign economic policy'. The conference explored approaches to a more cohesive foreign economic policy in areas such as monetary and exchange-rate policies, and discussed the hot topic of international financial regulation and supervision. Lessons from EU trade, energy and development policies were highlighted by contributions from other EU Directorates-General.

## The Lisbon fitness plan

A Commission progress report on the implementation of the Growth and Jobs initiative was adopted by the spring European Council on 19-20 March. The country chapters detail Member States' progress in applying the reforms needed to achieve the Lisbon and employment targets. Referring to the Lisbon Strategy as a medium-term 'fitness plan', President Barroso said, "Member States must agree and implement the much-needed structural reforms set out in today's recommendations, to pave the way for a gradual but lasting return to creating growth and jobs within a greener, fairer economy". While painting a sobering picture, the report highlights positive points such as the constructive responses to the crisis in all Member States and the actions to combat rising unemployment.
**www.ec.europa.eu/growthandjobs**

## Rebalancing in the Baltics

On 25 March, participants at a DG ECFIN seminar on economic policy challenges in the Baltic States heard about the current policy challenges facing Latvia, Lithuania and Estonia. The thematic sessions covered the boom and its aftermath, the roles of financial services and public finances, and the structural reforms needed to raise their growth potential. The serious loss of competitiveness experienced by these economies and the responses needed was a key issue.

## Interim forecasts: an uncertain outlook

Amid exceptional uncertainty about global developments, on 19 January the Commission released an early, extended interim economic forecast which estimated economic growth to have dropped to about 1% in 2008 in both the EU and the euro area (down from just below 3% in 2007). The deteriorating outlook presented in the interim forecast was the result of the impact on the real economy of the intensified financial crisis and the ensuing global downturn. The full spring economic forecast, due in early May, is expected to paint an even darker picture.

## Campaigning for the euro


The Commission is launching an EMU@10 advertising campaign in airports and in-flight magazines to foster a better understanding and a more positive feeling towards the euro among euro-area citizens. The campaign focuses on six of the more 'euro-sceptic' euro-area Member States. The airports include Schiphol in Amsterdam, Paris Charles De Gaulle and Milan Malpensa. Many surveys on perceptions of the euro conducted in past years have shown that significant parts of the general public continue to be sceptical about, or are unaware of, the benefits of the euro and EMU.

## Sticking to aid commitments

In April the Commission presented a Communication on EU aid to developing countries to help them cope with the economic crisis. Latest figures for 2008 show EU aid rose to €49 billion, up from €46 billion in 2007, and this was additional money not debt relief. The Commission proposes that Member States frontload and streamline aid delivery and focus spending on social safety nets, infrastructure, agriculture, green growth and trade. Development Commissioner Louis Michel called on Member States to honour their aid commitments even if, in the context of the financial crisis, this requires a considerable political effort.

## EU financial support for Romania

On 25 March, the EU announced a €5 billion support package for Romania to help relieve pressure on its economy owing to the financial crisis. The aid is supplied as medium-term financial assistance to support Romania's balance of payments under an existing facility for non-euro-area Member States. It will be accompanied by additional support from the IMF and other institutions, bringing the total package up to €20 billion by 2011. The EU is supplying similar financial support to Hungary and Latvia to underpin their economic recovery plans.

## Latest QREA: euro-area competitiveness

The first 2009 issue of the Quarterly Report on the Euro Area was released on 31 March. In addition to the regular review of the latest economic and financial developments, this issue features a special report on 'Competitiveness developments in the euro area'. The special report provides a comprehensive review and assessment of developments in competitiveness and current accounts in the euro area since the launch of the euro in 1999. It analyses the causes of Member States' divergence in competitive positions over the past decade. It argues that some of this divergence can be related to domestic macroeconomic imbalances that call for better economic policies. The report also looks into possible interactions between competitiveness divergence and the ongoing financial turmoil.

## Unity, confidence and determination

In a Communication published on 4 March, the Commission called for a united EU front in the fight against the crisis and the acceleration of financial market reforms in line with the report prepared by an expert group headed by Jacques de Larosière. "Today we are asking EU leaders to agree on a comprehensive action plan," said Commission President José Manuel Barroso, "to do everything possible to protect our citizens from unemployment, to clean up financial markets on the basis of the Larosière report, and to pave the way for Europe to lead by example and by persuasion as we approach the G20 summit in London." The Communication outlines upcoming initiatives on hedge funds, private equity and remuneration structures as well as infrastructure investments to help stimulate the economy.

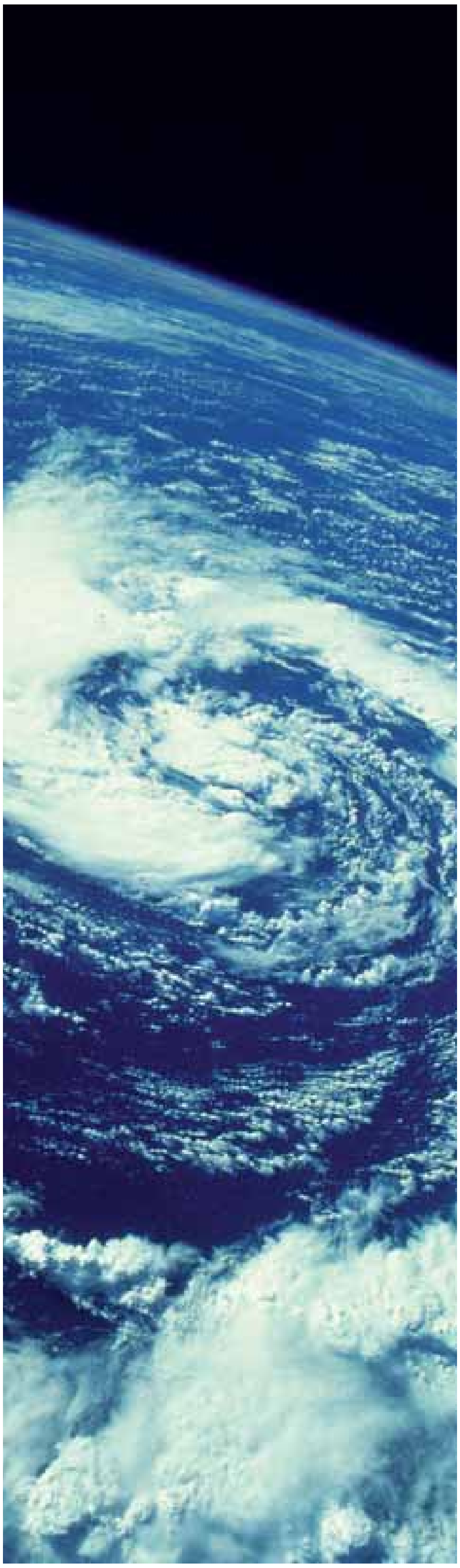
## Public finances under stress

In February, the Commission published its annual assessments of 21 of the Stability and Convergence Programmes submitted by the Member States – the remainder being expected later in the spring. The sharp economic downturn is having a marked impact on national budgets, with eight of those assessed projecting deficits of over 3% in 2009, and some significantly so. This partially reflects the adoption of differentiated fiscal stimulus packages in line with the European Recovery Plan which called for timely, targeted and temporary measures by those states with fiscal room for manoeuvre. Commissioner Almunia emphasised that the Stability and Growth Pact must remain the framework for EU recommendations on fiscal policy. "The application of the revised SGP will help return to sound and sustainable public finances once the recession is over and growth resumes," he remarked at a press conference on 18 February. On the basis of the Commission's recommendations, on 24 March the Council opened excessive deficit procedures in respect of Greece, France, Ireland and Spain.

**Further information**

The latest news and press releases from DG ECFIN are available at:
**http://ec.europa.eu/economy_finance/index_en.htm**

# Containing the financial fallout



***Now that the financial crisis has infected the wider economy, Europe and many other parts of the world are facing up to the prospect of a deeper and more drawn-out recession. But timely action is supporting global demand and has so far averted the financial meltdown some feared might occur. Now the EU and its Member States are implementing policies that will help Europe claw its way back to growth.***

After a period of hoping that the financial crisis would be a flash in the pan, the world is now coming to terms with the prospect that we are in for a deep and extended recession. "We are facing a very serious, difficult economic situation in all of our countries," said Economic and Monetary Affairs Commissioner Joaquín Almunia. "Europe is equipped to help the weakest economies within the EU."

Issue 12 of *European Economy News* traced the causes of the financial crisis and explored the coordinated policy responses EU countries have pursued to contain it and stimulate a rebound. Despite the gloomy mood, analyses reveal that the robust and timely measures taken under the European Economic Recovery Plan (EERP) will have a measurable impact.

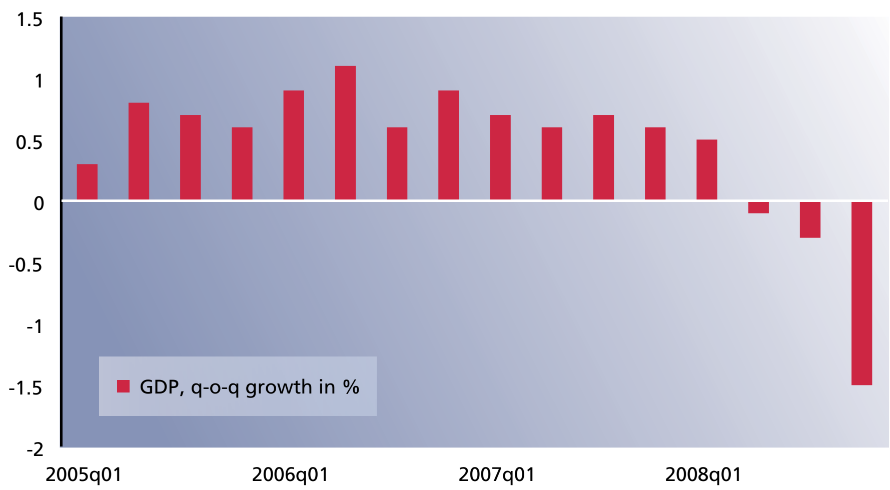
DG ECFIN estimates that the envisaged measures will limit the contraction in GDP growth by about 0.75% in the EU this year (see chart 1). "The stimulus packages are generally well targeted," remarks Marco Buti, Director-General of ECFIN. "If well implemented, they will stimulate domestic demand by providing support to credit-constrained households and enterprises, supporting employment and directly increasing demand through public investment. However, this effect will only be felt over time."

Despite the stimulus measures, the financial crisis has leaked out into the wider economy. This article explores the extent of this seepage, how this has occurred and what responses Europe has taken or will and should take to deal with the economic repercussions of the financial crisis.

## Feedback loops

Amid growing global gloom, the economic prospects for Europe appear sluggish. "The global financial crisis was caused by a multitude of complex factors," Buti stresses. "The initial shocks stemming from the financial market developments have been followed and amplified by the negative feedback loop between the real economy and the financial markets. A key ingredient of this loop

**Chart 1: GDP growth, EU-27**




Source: Commission services

# “Europe is equipped to help the weakest economies within the EU.”

## Economic and Monetary Affairs Commissioner Joaquín Almunia

has been the rising cost of financing. The legacy of accumulated imbalances in the world economy may lead to a painful adjustment process, thus further extending the period of weakness in economic activity.”

Moreover, feedback is a two-way street, and growing economic woes are beginning to affect financial markets, too, as economic activity slows down. At this stage, it is difficult to disentangle supply-side effects as a result of the financial crisis and demand-side effects.

Nevertheless, the situation is not all gloom. “The economic outlook remains uncertain as the world faces its worst crisis since the Second World War,” acknowledges Reinhard Felke, head of the economy of the euro area and EMU unit at DG ECFIN. “However, Member States and central banks have taken decisive action and once these policy measures gain traction, they are expected to provide tangible support to aggregate demand.” Total support provided by fiscal policies under the EERP is estimated to amount to 3.3% of GDP.

But the EU is not out of the woods yet. “There is broad agreement that a coordinated approach between Member States is needed to restore the flow of credit to the real economy and to stop the downward spiral of balance sheet adjustment and falling demand. Coordination is required to avoid distortionary effects and ensure that the single market remains the backbone of the European integration project,” emphasises Buti.

### Sluggish times

The current instability and uncertainty notwithstanding, the Commission forecast earlier this year that real GDP – after years of sustained growth – would fall by about 2% in both the euro area and the EU at large, and would begin to turn the corner in 2010, with modest growth of 0.4%. However, in light of the most recent figures for the first quarter in 2009, downside risks to the Commission’s already grim interim forecast of January are materialising rapidly and a more marked fall in GDP can no longer be excluded. Other institutions have already revised down their projections still further. For instance, the ECB’s March staff projections forecast average euro-area real GDP to contract by 2.2-3.2% in 2009. The contraction is broad-based with the main countries experiencing a deep fall in activity simultaneously.

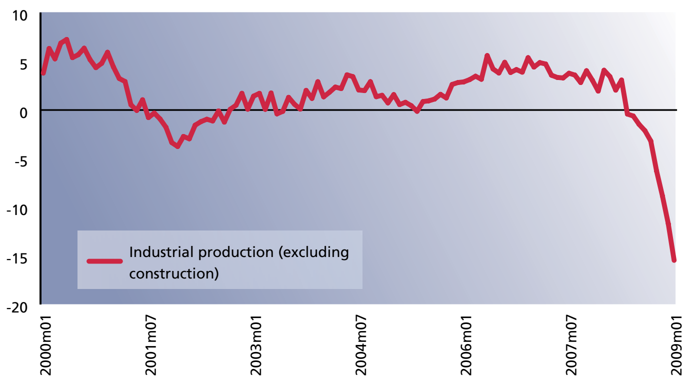
Besides the collapse of trade and exports, and the ongoing correction of housing prices in several countries, inventories accumulated rapidly in the second half of last year as businesses were repeatedly surprised by the decline in demand. This points to a risk of a further, significant downward adjustment of output ahead.

Unsurprisingly, labour market prospects are also looking shakier. After several years of sustained job creation, employment contracted in the EU by 0.2% and 0.3% (quarter-on-quarter) in the third and fourth quarter of 2008 respectively. In 2009, the EU is likely to shed around 3.5 million jobs. The countries where unemployment is likely to grow the most rapidly include Spain, Ireland, the United Kingdom and Latvia. The unemployment rate in the EU stood at 7.6% in January (compared to 6.8% a year before) and is expected to increase to close to 9% in 2009, a rise of around 1.5%. Since labour markets tend to react with a lag, further deterioration could be on the horizon.

In addition, the global slowdown is hitting European industry hard. According to Eurostat, the EU’s statistical office, seasonally adjusted industrial production in the EU declined by 15.5% (and in the euro area by 16.1%) in January 2009 compared with January 2008 (see chart 2).

Understandably, economic confidence is flagging. The EU’s Economic Sentiment Index (ESI) has fallen by a total of 6.3 points (4.3 in the euro area) in the first quarter. The ESI now stands at 60.3 for the EU as a whole and 64.6 for the euro area – the lowest levels since the launch of the indicator series in January 1985. The general decline in confidence seen in all sectors in January and February gave way to a slightly more mixed picture in March, with consumer sentiment and construction stabilising and retail trade slightly improving. Indicators remain however at a very low level, showing no clear sign of a recovery in early 2009 – and confidence indicators are known to be a good GDP growth tracker.

**Chart 2: Industrial production, EU-27**
**(y-o-y growth rate in %)**




Source: Commission services

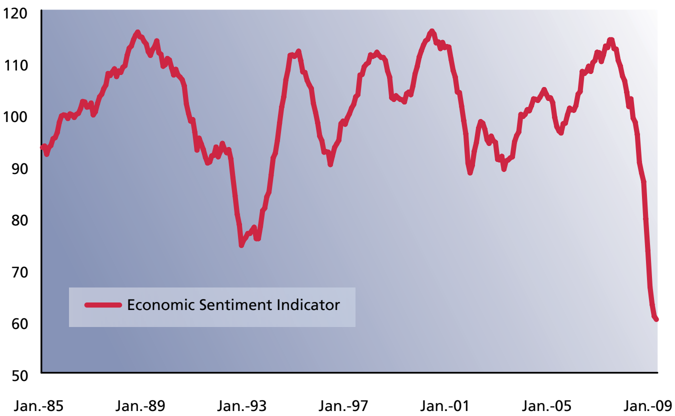
### No strain, no gain

Public finances are also feeling the strain, with the double burden of falling tax revenues and the costs of bailout and stimulus packages – which are largely in line with the Economic Recovery Plan proposed by the Commission and endorsed by EU leaders in

**"Coordination is required to avoid distortionary effects and ensure that the single market remains the backbone of the European integration project."**

**DG ECFIN Director-General Marco Buti**

**Chart 3:**
**The Economic Sentiment Indicator, EU-27**




Source: Commission services

December. The headline deficit is expected to more than double this year in the EU, hitting 4.5% of GDP in 2009 as opposed to 2% in 2008 (and up to 4% from 1.75% in the euro area).

The EU's economic and monetary union (EMU), of which the euro is the ultimate manifestation, is underpinned by the Stability and Growth Pact which obliges Member States to respect fiscal discipline, including the size of budget deficits and public debt. According to Commission assessments, almost all Member States are likely to see their budgetary positions deteriorate in 2009 and, assuming policies remain unchanged, this will continue into 2010 for more than half of the Member States. In aggregate, this implies worsening fiscal situations equivalent to some 2.5% of GDP in 2009 and 0.5% in 2010.

Reformed in 2005, the pact allows euro-area countries enough flexibility to take targeted action to stimulate their economies in crisis situations, while safeguarding their return to a more sustainable fiscal policy path in the medium term. That is why stimulus packages need to respect the three Ts: they have to be timely, targeted and temporary. As Almunia put it, "to maintain the confidence of the citizens in the capacity of their public authorities to preserve [the sustainability] of their public finances over the medium to long term, we need to implement the pact. We need to implement it in a flexible way… [The pact] is an instrument that will help… Member States fight the recession in the short term, preserve the sustainability of public finances in the medium term, and advance towards an exit strategy once the recession [is] over in order not to put a huge burden on the next generations."

Nevertheless, vigilance is called for. Based on its assessment, the Commission adopted recommendations to help EU finance ministers decide – at the meeting of the Economic and Financial Affairs Council (ECOFIN), which took place in Brussels on 10 March – on what corrective action is currently needed, if any, for countries running excessive deficits. In order to safeguard confidence in the sustainability of public finances, most Member States are expected to start consolidation next year and to correct excessive deficits not later than 2012. However, Member States with very large deficits have already started consolidating.

## A world of difference

The current turmoil is not limited to Europe alone; it permeates the entire world. This means that a coordinated global approach is crucial. A remarkable aspect of the current crisis is the extent to which the major economies of the world, both developed and emerging, are working together to contain the fallout. A major driving force behind this success has been European leadership.

There has been close coordination between the so-called G20, a group of the world's top 20 economies. "The EU is very active in the G20 process and played a pivotal role in initiating it," explains Heliodoro Temprano Arroyo, acting head of unit in charge of international economic aspects of globalisation.

At the G20 meeting in mid-November in Washington, the assembled leaders even agreed to work to resume the stalled Doha round of world trade negotiations. The G20, whose members represent 75% of the global economy, assembled in London this month to review progress and agree on future actions. "World leaders cannot afford for the G20 summit to fail and there is a real need to restore global confidence," stressed Mark Malloch-Brown, the UK prime minister's special envoy for the G20 London summit.

The London summit set itself the ambitious goals of further coordinating actions to revive the global economy, reforming and improving financial sectors and systems, and agreeing principles for reforming international financial institutions.

"There is an ongoing review of the international financial architecture and global financial governance," points out Buti. "Here, in the EU, we're reviewing the internal governance of financial markets to avoid future crises of this nature. We're helping shape a new consensus on the scope of regulation and coordinated supervision. We're ahead of the G20 on this and so our experience can provide some guidance on this matter."

Reforming global financial systems ought to make them more efficient, equitable, sustainable and suitable for the times. Both Britain's Gordon Brown and France's Nicolas Sarkozy have called for a 'new Bretton Woods', evoking the need for an overhaul as radical as that undertaken following World War II.

"We must grasp this opportunity to drive forward a restructuring of global governance – including the Bretton Woods institutions – so that they reflect the geopolitical realities of the 21st century," Commissioner Almunia has said. The Commission believes global financial institutions – such as the International Monetary Fund (IMF), the World Bank and the Financial Stability Forum – should be made more equitable and Europe needs to consolidate its position within them.

**Further information**
'Financial crisis' on the DG ECFIN website:
**http://ec.europa.eu/economy_finance/focuson/focuson13254_en.htm**

# Global plan for recovery and reform: the G20 London summit


**"The decisions taken today are much more ambitious than was expected."**

**Commission President José Manuel Barroso**

***With the EU at the forefront, leaders from the world's largest 20 economies met in London at the latest G20 summit on 2 April to agree a coordinated action plan to put the world economy back on a growth path and to reform global financial institutions.***

Both the financial crisis and its economic fallout have gone from local to global. Despite the rapid and coordinated global responses so far, the world is not out of the woods yet. Most forecasters predict that the global economy will shrink in 2009, to an extent which has not occurred since World War II, and the International Labour Organisation forecasts that 50 million jobs could be lost by the end of the year. The situation has become so serious that the International Monetary Fund chief Dominique Strauss-Kahn is calling it the 'Great Recession'.

Against this backdrop, the leaders of the so-called Group of Twenty, a group of the world's largest 20 economies who together represent 85% of the global economy, met in London. Hosted by UK Prime Minister Gordon Brown, the assembled leaders included US President Barack Obama, French President Nicolas Sarkozy, German Chancellor Angela Merkel, Italian Prime Minister Silvio Berlusconi, European Commission President José Manuel Barroso, China's President Hu Jintao, as well as the leaders of Japan, Russia, India, Brazil and the other G20 members. They gathered to hammer out the next phase of their coordinated approach to charting a course out of the current crisis.

The G20 agreed a bold US$1 trillion (€800 billion) package to help the global economy turn the corner. "The decisions taken today are much more ambitious than was expected," commented Commission President José Manuel Barroso. "That is the result of hard work but also of the spirit in which the discussions were conducted."

## Jump-starting the economy

Prior to the summit, G20 finance ministers and central bank governors met to pave the way to an action plan which focuses on restoring global growth and strengthening the international financial system.

In order to kick-start global growth, the G20 summit agreed to do everything necessary to unblock credit flows and implement swiftly the economic stimulus measures announced so far in order to boost global demand and create jobs. "The key to recovery is boosting global demand. Demand means jobs. And jobs are our first priority," commented Barroso.

"In Europe, our fiscal effort is over €400 billion. It will rise to nearer €500 billion. The priority is now to implement the discretionary part of it quickly, and in full," Barroso noted.

In addition, G20 leaders agreed to support emerging and developing economies to cope with the reversal in international capital flows. The World Bank estimates that emerging economies will face a combined financing gap in 2009 of at least $270 billion and possibly as much as $700 billion. Towards that end, the G20 has decided to triple the IMF's 'war chest' to up to $750 billion, as well as agreeing a $250 billion increase in global money supply. Leaders also agreed to reinforce the tools available to the IMF, so that in future the Fund will not just be able to react to crises but will be in a better position to help prevent them.

## From recovery to reform

The G20 also agreed on ambitious measures to reform and strengthen the international financial system to help avoid another crisis, including enhanced regulation of major markets, tougher post-recovery financial regulation, and strengthened international co-operation to prevent and resolve crises. In future, regulations will apply to every bank, everywhere, every time. Among the groundbreaking initiatives are new rules on bank pay and bonuses, a blacklist of tax havens that could lead to sanctions and making large hedge funds 'for the first time' subject to regulatory oversight. Such reform ought to make global financial systems more resilient to shocks, as well as more efficient, equitable and sustainable.

The G20 summit delivered a strong message of global unity in the face of the ongoing crisis. The fact that G20 members have been able to agree to coordinate so closely is a considerable achievement. A major driving force behind this success has been European leadership. "The European mark is clear in the conclusions. With our friends and partners, a united EU is driving this process," said Barroso. ■

**Further information**

G20 Summit news on the europa server:

**http://ec.europa.eu/news/economy/090402_1_en.htm**

# Changeovers made easy

## 'The introduction of the euro has had no perceptible impact on prices'

***Introducing euro cash is a logistical challenge of the first order – and the EU has risen to it on every occasion. The collective experience gathered during the euro 'big bang' of 2002 and subsequent changeovers has set a 'gold standard' for the switch which maps out the smoothest route for new entrants into the euro area.***

Cast your mind back to 1 January 2002, 'E-Day' as it became popularly known. As fireworks went off at midnight, euro notes and coins officially became legal tender in 12 European countries with a population of over 300 million, with curious citizens queuing at cashpoints to withdraw their first euros.

But this massive currency switchover, the largest in human history, was a complex logistical operation which involved the printing and minting of an astonishing 7.4 billion notes and 38.2 billion coins. This money then needed to be distributed by citizens through banks and businesses, such as retailers, while the old 'legacy' currencies had to be eased out of circulation.

Despite a certain amount of apprehension that chaos might ensue, the smoothness of the whole changeover surprised everyone. By 3 January 2002, an astonishing 96% of all cash dispensers in the euro area were issuing euro banknotes, and only a week after the introduction more than half of all cash transactions were in euros.

### Euro evolutions

Since then, the euro area has grown to embrace four additional countries: Slovenia (2007), Cyprus (2008), Malta (2008) and Slovakia (2009). Like any evolutionary process, each new entrant benefited from the experience of the previous ones and the EU honed and fine-tuned the switchover through an ongoing learning process.

### So, what lessons have been learnt?

"Businesses need time to adjust to the imminent reality, and so we need to start with them. First-wave countries had the advantage that they had three years to prepare. This is no longer the case. Businesses now have a maximum of one year, and the conversion rate – a key element – is only known very late," explains Benjamin Angel, head of DG ECFIN's euro cash unit.

Closer to the actual launch date, citizens must be readied for the changeover, with practical guides, support services, etc. From previous experience, it has been found that euro starter kits are worth their weight in gold. "You don't have the equivalent of ATMs for coins, so selling coin mini-kits to citizens in the run-up is crucial to smooth the introduction of coins," notes Angel.

And "every citizen needs to be fully informed about the new currency", adds Roman Schoenwiesner, head of ECFIN's communication unit, which coordinates the EU's technical and financial support for the high-profile publicity and awareness-raising campaigns required.

### E-day

Once 'E-Day' arrives, it is crucial that the break with the legacy currency is a quick and clean one. "Speed is of the essence. Simulations show that an intense and prolonged dual circulation makes queues longer and causes bottlenecks and problems," Angel states.

This is why the EU has pushed the banking sector to implement immediate changeovers. "At first, banks wanted two months to adapt their ATMs. We persuaded them that an immediate changeover was best because it avoided reintroducing the legacy currencies into the economy," emphasises Angel.

The retail sector plays a vital role as a "vacuum cleaner" for legacy currencies, but "some retailers need help assessing their euro cash needs, and that's why we recommend that Member States provide businesses with tools and support to manage the switch", points out Angel. As a rule of thumb, retailers need four to five times the amount

of cash they normally carry during the changeover period, as they cannot recycle the legacy currency spent by customers as change.

### Tight rein on prices

To date, the introduction of the euro has had no perceptible impact on prices. In fact, in its first ten years inflation was actually lower than previous decades and less than in the United States. It averaged 3.3% per year in the 1990s, but fell to an average of 2.2% in the single currency's first decade.

Nevertheless, public perceptions can be quite different. For instance, one 2006 Eurobarometer poll found that 90% of respondents in the euro area felt that the single currency had added to price rises. "Fear of price rises is one of the greatest public worries during changeovers," observes Angel. "We have developed a complete package of measures to deal with this, including compulsory dual pricing, name and shame campaigns, etc." He held up Malta, which investigated every reported case of unfair price increases immediately, as a model case. And the effort paid off. "In Malta, the inflation perception went down strongly, despite the large rises in global food and energy prices at the time of the changeover." ■

**Further information**

More information on adopting the euro can be found on DG ECFIN's website:

**http://ec.europa.eu/economy_finance/the_euro/the_euro6480_en.htm**

# Enlargement: good for all

***The fifth wave of EU enlargement marked a milestone in reunifying Europe a decade and a half after the end of the Cold War. Twelve countries from Central and Eastern Europe and the Mediterranean have joined the EU over the past five years, ten of them in 2004 and two more in 2007.***

In addition to making the EU politically and economically stronger, enlargement has led to higher growth and increased living standards, both for the newest Member States and the 15 they joined. These benefits are documented in 'Five years of an enlarged EU', a DG ECFIN report released on 20 February 2009.

## Benefits to new Member States

The biggest beneficiaries of the enlargement were the 12 new Member States. The accession process boosted economic growth in the new Member States by an average of 1.75% per year from 2000 to 2008. As a result, living standards in the new Member States have risen, with average income per capita reaching 52% of that of the old Member States in 2008, compared to 40% in 1999. The growth was mostly attributable to capital accumulation and productivity increases.

Workers also benefited. Since 2004, job growth has risen by about 1.5% annually on average. About 3 million new jobs were created between 2003 and 2007, with unemployment declining to around 7% by 2007, about the same as the rest of the Union.

The rapid trade integration with the rest of the EU also boosted exports and imports, which now make up a 56% share of the new Members' average GDP, compared to 47% before enlargement. While the level of exports from new Member States to the rest of the EU has been broadly stable at 80%, important shifts have occurred. Trading among new Member States has increased to make up about 19.5% of their exports in 2007 compared to 13.2% in 1999. Meanwhile, old Member States have increased exports to new Member States to 7.5% of total exports from 4.7% over the same period.

Increased trade integration in the EU exploits comparative advantages, and thus strengthens the growth potential and enhances the competitiveness of the EU as a whole, the report states.

## Rapid modernisation and integration

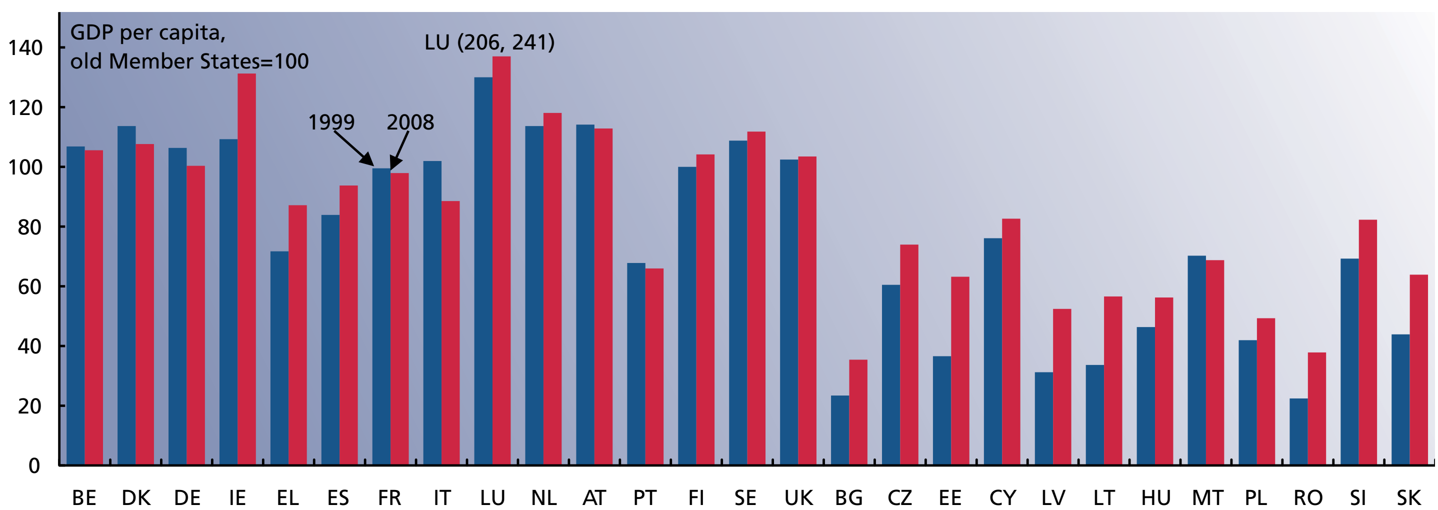
"It is clear that the EU makes a difference. By adopting its regulatory and policy framework, the new Member States were able to grow faster and are now better placed to weather the global financial storms," said Filip Keereman, head of the unit responsible for monitoring the economies of the Czech Republic, Poland, Romania, Slovakia and co-ordinator of the report (together with ECFIN's Research Director István P. Székely).

The new Member States also benefited through the rapid modernisation of their economies. While agriculture and manufacturing play a more important role in their economies than in the rest of the EU, a transformation to a more service-based and knowledge-intensive economy is taking place. The service sector contribution to the economy grew from 56% of GDP in 1995 to 63% in 2006, compared to 72% of GDP in the old Member States.

Investment and better-functioning financial markets helped generate substantial foreign direct investment inflows, creating new jobs and raising living standards. Increased investments from old Member States have been a key driver of economic transformation in the new Member States.

The EU accession process also led to a new framework for product market regulation in the new Member States, resulting in increased internal competitiveness. According to a Eurobarometer survey of 2007, 71% of small and medium-sized enterprises in new Member States feel that there has been a significant increase in competition since accession. State aid in the new members has declined as a share of GDP from 1.5% in 2000 to

**Per capita GDP in the EU, 5 years before and 5 years after enlargement**




Source: Commission services

**"It is clear that the EU makes a difference."**

**Filip Keereman, Head of Unit, DG ECFIN**

0.5% of GDP in 2006, a level just above that in the old Member States.

## Benefits to old Member States

The economic record shows that the burst of growth experienced in the new Member States did not come at the expense of the old Member States. In the latter, GDP grew by an average of 2.2% annually from 2004-2008, similar to growth in the five years before enlargement began.

Furthermore, enlargement is estimated to have contributed to a cumulative increase of about 0.5% in output in the old Member States over the same period, especially in those countries that increased trade with and investment in the new members. Overall, enlargement benefited the EU as a whole.

## Labour migration: a strength or a problem?

The report also addresses concerns about the economic effects of labour migration from the new to the old Member States. For workers in the new Member States, the ability to move to and work in many of the old Member States has improved their employment opportunities and income prospects. It has contributed to lower unemployment in the new Member States, while filling employment gaps in the old.

On the other hand, outward migration has raised concerns in some countries (notably Lithuania, Poland and Romania) about brain drain, skills mismatches and labour shortages in specific sectors and professions. However, these labour market problems are being alleviated by an increase in the supply of highly educated people, while improving economic conditions have also reduced incentives to work abroad. In addition, workers returning from a stint abroad are expected to bring back new skills that will make a valuable contribution to their home economies. Furthermore, remittances from abroad can make an important contribution to the domestic economy. In Bulgaria and Romania, remittances account for about 5.5% of GDP, while in Poland they account for 1.5% of GDP.

## Labour migration at a relatively low level

In the old Member States, concerns about a massive labour influx from the new members and the resulting economic impact have not materialised. In fact, the record shows that labour migration from the new Member States has been relatively small. In total 2 million people have migrated from new to old Member States since accession, joining the 1.6 million already living in the EU at the end of 2003.

The total number of inward migrants accounts for 1% or less of the working-age population in most host countries. Ireland is the exception with 5%.

Incoming workers have helped old Member States meet labour market demands and reduce bottlenecks – for example in the construction and services sectors – without creating major labour market disturbances.

Migrants from the new Member States also tend to be more willing to work in low-skilled jobs. About 33% of migrants work in low-skilled jobs compared to 10% of resident workers, even though their educational attainment compares very well to that of the domestic workforce.

"Evidence at hand suggests that the impacts of post-enlargement intra-EU mobility have not led – and are unlikely to lead – to serious labour market disturbances," the report states. "This is not to say that there have been no economic and social costs. However, experience suggests that instead of restricting labour market access of EU nationals, alternative solutions may be a better and more effective way to address these costs."

The free movement of labour is an important benefit and an economic strength in a unified Europe, the Commission points out in the Communication issued with the report. It is estimated that the recent level of intra-EU labour mobility adds about 0.3% to the GDP of the EU as a whole in the medium term.

In addition, the number of migrants from new Member States is not expected to rise substantially, even after the remaining transitory restrictions in some Member States are lifted, the report notes. A large part of intra-EU mobility appears temporary.

As a result, the Commission has called upon old Member States to consider whether they need to continue applying restrictions on labour from the new Member States.

### Countries which joined the EU in 2004

Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia

### Countries which joined the EU in 2007

Bulgaria, Romania

## Preparing Europe for the challenges of globalisation

In general, enlargement has hastened the pace of economic reforms throughout the EU, preparing Europe for the challenges of globalisation by making it more competitive in the world.

Speaking at a conference in Prague on 2 March to review the 2004 and 2007 accessions, Joaquín Almunia, the European Commissioner for Economic and Monetary Affairs, said the enlargement had resulted in a "win-win" situation for both new and old Member States and the EU as a whole.

"The current global crisis is creating difficulties for all countries throughout the world, and unemployment is rising everywhere," he said. "But a big, united EU is better able to address this and other challenges than if its Member States act alone. Together and united we can overcome this crisis. Divided we will achieve nothing." ■

**Further information**

Five years of an enlarged EU. Economic achievements and challenges:
**http://ec.europa.eu/economy_finance/publications/publication_summary14081_en.htm**
DG ELARG enlargement at 5 webpage:
**http://ec.europa.eu/enlargement/5years/index_en.htm**

# Productivity and growth: keeping the long term in perspective


***Every year, DG ECFIN's Annual Research Conference presents current research and insight into issues relating to Europe's economy. Last year's event, held on 16-17 October, heard from economists from DG ECFIN, universities and research institutes on the role of international flows of goods, services, capital and labour in boosting growth and productivity.***

Tackling Europe's slow productivity growth will play a crucial role in helping EU Member States emerge from the current global financial crisis with stronger, more competitive economies. High productivity growth is considered to be closely associated with rising living standards, as it drives growth in workers' earnings.

Commissioner Joaquín Almunia's opening remarks to the conference stressed the need for in-depth analysis of the long-term links between international integration and growth in these difficult times. While short-term issues relating to the crisis are important, policy-makers need to keep the long term in perspective as well.

"We will need comprehensive and targeted strategies for increasing productivity and growth in our economies," he said. "Not least because the long-standing challenges to European growth have not disappeared and have become even more pressing."

## Financial markets and globalisation

Bart van Ark, a professor at the University of Groningen and Chief Economist at the Conference Board in New York, picked up the theme in his keynote address on the short-term impacts of the financial market crisis and the importance of globalisation. He said that the crisis would bring about a worldwide re-examination of how to meet global financial needs for long-term growth and sustainable development.

Investment and productivity gains accounted for the accelerated growth in the world's economies during the 1995-2005 period, he noted. International flows of goods, services, capital and labour are key to future growth.

The risks ahead in the coming years include a shortage of global talent, which could become one of the main bottlenecks in sustaining long-term growth worldwide. Climate change issues and sustainable development will need huge investments in technology and innovation.

Van Ark also expected the crisis to lead to a re-examination of the world's financial architecture. He warned that the current trend towards financial conservatism in the global financial system could reduce the potential of financial markets to spread risk. The current financial crisis meant that international coordination and co-operation on regulations and institutions are now more important than ever.

## Differences in industry sector productivity

Kieran McMorrow, an economist at DG ECFIN, presented a paper analysing the industry-specific determinants of the productivity growth gap between the

*The 2008 conference was organised by Lars Jonung and Oliver Dieckmann of DG ECFIN's research advisers group.*

# "We will need comprehensive and targeted strategies for increasing productivity and growth in our economies"

## Economic and Monetary Affairs Commissioner Joaquín Almunia

EU and the US. The analysis found that the gap is explained by the better US performance in a handful of market service industries – notably in the retail and wholesale trades – and in ICT-producing manufacturing. The EU has a stronger performance than the US with respect to a number of network utilities.

### Investing in higher education

Another keynote speaker, Richard Freeman, a professor at Harvard University, presented his analysis of the implications of investment in higher education for globalisation. He argued that international flows of students and highly educated immigrants were more important to growth than flows of goods, capital and services. Multinationals tend to invest in economies with an educated workforce and where scientific innovation is being produced, he said.

As technology levels the differences between developed and emerging economies, differences in wages related to the rates of innovation should diminish. In such an environment, attracting international students becomes a major form of migration policy, and universities become a competitive source of comparative advantage, he explained.

### Explaining differences in productivity and R&D investment

Next, DG ECFIN economist Werner Röger used a growth model to identify possible sources for the productivity and knowledge investment gap between the EU and the US. The framework allowed him to explain differences in productivity and R&D spending levels. The analysis showed that competition in the goods market and entry barriers for innovative firms are likely factors in explaining both the lower productivity and R&D spending in the EU.

Professor Eric Bartelsman of Amsterdam's Vrije Universiteit argued that it was difficult to assess the effects of policy on productivity using current analytical models of the representative firms. By extending the model to include different types of firms, researchers are able to show how policy can affect aggregate productivity through many avenues, including the efficiency of resource allocation, he said.

### Trade-offs between migration and growth

Tito Boeri, a research fellow at Igier-Bocconi and professor of economics at Bocconi University in Milan, discussed research into the trade-off between migration and economic growth. He argued that the skill composition of migrating workers affects economic growth.

When migration increases the share of skilled workers in a given population, a positive impact on output per capita is to be expected. The extent of that impact depends on the degree to which migrants are assimilated into the population.

When questioning whether European economies have made the right policy choices in these terms, he found that the large variation among countries in the skills of migrants they attracted could be explained more by government policies and the types of labour market institutions in place than by 'welfare shopping' on the part of migrants themselves. When immigration policy relies on a points system, such as that implemented by Canada, New Zealand and Switzerland, immigrants are found to be almost as skilled as natives, he said.

Marco Terrones, an economist with the IMF, discussed the relationship between financial openness and total factor productivity (TFP) growth. He presented data that provided strong evidence of a boost to TFP growth from foreign direct investment.

In the final session of the conference, Erik Berglöf, Chief Economist of the European Bank for Reconstruction and Development, described the long-term challenge of the constraints to growth in transition economies, which vary depending on the country. A lack of competitive structures after the transition from a state-controlled to a market economy, and gaps in the quality and coverage of education are among the factors that could constrain growth, he concluded.

### Maintaining high growth rates

Kari Alho, an economist with the Research Institute of the Finnish Economy (ETLA), presented an analysis of the convergence of the new EU Member States with the old and the impact of offshoring on new and old Member States. He found that the EU's new Member States would maintain high growth rates with high inflation for the next decade, while intensifying integration would only lead to small gains.

In a panel discussion at the end of the conference Marco Buti, DG ECFIN's Director-General, observed that due to the financial market crisis the "megatrends" of globalisation, ageing and climate change, as identified in DG ECFIN's study EMU@10, appear to have become more prominent earlier than expected. The integration of the world's financial markets had increased the impact of the crisis worldwide.

International institutions will play a role in shaping the exit strategies for governments that are now intervening in the workings of markets. These interventions should be designed so that they ensure consistency between short- and long-run objectives of economic policies.

The present global financial crisis that started with the subprime crisis in the US in 2007 can be expected to impact not only on the financial sector and the real economy, but also on the willingness to implement reforms, for instance to improve the design of the financial system and on the paradigms that are behind our economic thinking.

These interrelated issues will be in the centre of this year's DG ECFIN's Annual Research Conference on 'Crisis and Reform', to be held on 15-16 October 2009 in Brussels. ■

**Further information**

More information on the Annual Research Conference:

**http://ec.europa.eu/economy_finance/events/event13393_en.htm**

# Looking ahead

## For your diary

### 14-15 May 2009
### The Brussels Economic Forum

#### Beyond the crisis:
#### A changing economic landscape

In 2009, the Brussels Economic Forum celebrates its 10th anniversary with a programme focusing on the changing conditions and future challenges that face the economies of Europe and the world after the crisis. It will include sessions on the place of Europe in the global economy, and the financial crisis and the consequent design of a new rule book. There will also be a special session organised in co-operation with the Czech Presidency of the European Union on the sustainability of public finances, following the adoption of the 2009 ageing report by the European Commission.


### 25-26 May 2009
### ECB conference in Frankfurt

#### Retail payments: integration and innovation

Organised jointly with the Netherlands Central Bank (DNB), this conference aims to improve understanding of retail payment economics – particularly in light of the creation of the Single European Payments Area. It will help identify possible developments and dynamics that will shape the future retail payments landscape as it becomes increasingly integrated and consolidated. Participants will include economists and researchers from academia, central banks and financial institutions.

**www.ecb.int/events**

### 12 June 2009
### Euroframe conference in London, United Kingdom

#### Causes and consequences of the current financial crisis: what lessons for European Union countries?

The Euroframe group of research institutes from across Europe will hold its 6th conference on economic policy issues in the EU. This year, the conference will focus on the lessons to be drawn from the current financial crisis and investigate its causes, such as the search for high profitability, growth based on debt and capital gains, and the behaviour of banks. Developments in the crisis and the policy responses will also be considered, including the successes and failures of government measures and the appearance of vicious circles in markets.

**www.euroframe.org**

### 23-24 June 2009
### OECD Forum in Paris, France

#### Beyond the crisis:
#### for a stronger, cleaner, fairer economy

This 10th OECD Forum will bring policy-makers, business leaders and other stakeholders together to discuss the hottest issues related to the current economic crisis. How can the economy be strengthened in the longer term? How to soften the impact of the recession? How to make international migration a win-win for sending and recipient countries? How to keep markets open for trade and investment? These are some of the issues that will be discussed during the Forum sessions. The Forum will take place in parallel with the annual OECD ministerial summit.

**www.oecd.org**

### 10-11 September 2009
### BIS/ECB Workshop in Basel, Switzerland

#### Monetary policy and financial stability

In co-operation with the Bank for International Settlements (BIS) the European Central Bank is organising this workshop to discuss the role of monetary policy in both crisis management and crisis prevention. Bringing together central bankers and academics, the workshop will consider the effectiveness of monetary policy measures, the costs of boom/bust cycles, transmission channels of monetary policy during cycles, and the lessons of the current crisis for central bank strategies.

**www.ecb.int/events**

### 15-16 October 2009
### DG ECFIN's 6th Annual Research Conference in Brussels

#### Crisis and reform

The 2009 research conference organised by DG ECFIN will bring together economists and policy-makers to discuss three interrelated key issues relevant to fundamental economic thinking on the current crisis and the lessons that can be drawn from it. 'The political economy of reform', 'the design of financial systems', and 'revisiting the economic paradigm' are the topics that will be covered in the conference sessions which will include an array of European and international speakers. The conference will seek insights into the interplay between political and economic issues in the reform process, the pros and cons of proposals for reforming financial systems in the light of lessons from the current crisis, and the challenges that the crisis is posing to classical economic thinking on market behaviour.

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

# Commission agenda

## April 2009

Together with the Economic Policy Committee, the Commission will publish the 2009 Ageing Report detailing the age-related expenditure projections for all Member States over the period 2009-2060, covering pensions, health care, long-term care, and education and unemployment transfers. These long-term projections are helpful in highlighting the immediate and future policy challenges for governments posed by demographic trends, and will be presented to the ECOFIN Council in May 2009.

## May 2009

DG ECFIN will publish the spring economic forecast for the EU and the euro area. Together with that published in the autumn, this is usually the major economic forecast for the EU and provides the basis for policy decisions. Forecasts for individual Member States are included.

## June 2009

DG ECFIN will publish the annual 'Public Finances in EMU' report for 2009. The report will analyse the implications of the financial crisis for fiscal policy and the role of fiscal policy in facilitating the correction of external imbalances.

## June 2009

The Commission will publish the June issue of the Quarterly Report on the Euro Area. This issue will include a number of analytical sections on a range of economic policy issues, including an analysis of the role of fiscal policy in intra euro-area adjustment, an assessment of the impact of ageing on budget and growth, a discussion of the concept of fiscal space and an evaluation of the impact of recessions on the long-term growth potential.

## June 2009

The Commission will publish the 9th progress report on preparations for the introduction of the euro. This report covers the economic developments in the euro-area candidate countries and their degree of preparations on the economic, monetary, legal and administrative aspects needed to adopt the single currency.

### Correction

In the last issue of this magazine, EEN 12 published in January, there is a repeated mistake in the Member State Profiles section. In the article on 'The EU's Nordics: responsive to changing circumstance', the three summary information boxes refer to *Public sector deficits*. In each case this should be *Public sector surpluses*. Denmark, Sweden and Finland all recorded surpluses in 2007.


## Editorial information

*European Economy News* is published by the External Communication Unit of the European Commission's Directorate-General for Economic and Financial Affairs.

Editor-in-chief: Marco Buti. Coordinator: Sophie Bland. Published quarterly, *European Economy News* is available in English. Subscription is free (see below). For more information, please contact the External Communication Unit.

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*European Economy News* website:
http://ec.europa.eu/economy_finance/een





Luxembourg: Office for Official Publications of the European Communities, 2009

ISSN 1830-5180





*Printed in Belgium*


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KC-AJ-09-013-EN-C

# Recent research and analysis by DG ECFIN

## European Economy Research Letter

The Directorate for Economic and Financial Affairs publishes a regular web-based newsletter on the research activities of its staff – the *European Economy Research Letter*. Topics in the forthcoming spring issue will include a focus on the 'Enlargement@5' research and analysis, the new Quest model, and an examination of housing markets. 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**

Economic and Monetary Union €10 ten years on

To mark the 10th anniversary of the launch of Economic and Monetary Union DG ECFIN economists and external academic contributors are producing research publications on aspects of the first decade of EMU and the euro. These publications are part of an EMU@10 umbrella project embracing a wide range of research activities. The publications can be downloaded via a dedicated website hosted by DG ECFIN which provides information and resources on EMU for economists and non-specialists. The website can be found at: **http://ec.europa.eu/economy_finance/emu10**

Some titles from the EMU@10 series are:

- Costs and benefits of running an international currency
- The role of the euro in sub-Saharan Africa and in the CFA franc zone
- Global impact of a shift in foreign reserves to euro

## 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.

The main *European Economy* series includes major reports and communications to the Council from DG ECFIN on behalf of the European Commission. *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 State. Some recent titles from these publications are:

### Economic Papers

#### Recent publications include:

- The quest for the best consumer confidence indicator
- A model-based assessment of the macroeconomic impact of EU Structural Funds on the new Member States
- An evaluation of the EU's fifth enlargement with special focus on Bulgaria and Romania
- FDI spillovers in the Czech Republic: Takeovers vs Greenfields

### Occasional Papers

#### Recent publications include:

- The quality of public finances and economic growth
- Progress towards meeting the economic criteria for accession: the assessments of the 2008 progress reports
- Recent reforms of the tax and benefit systems in the framework of flexicurity
- 2008 fiscal notifications of candidate countries: overview and assessment

### Country Focus series

#### Recent publications include:

- Impact of social expenditure on regional disparities in Poland
- The efficiency of public expenditure in Malta
- Cyprus: immigration, wage indexation and the adjustment in EMU
- Romania: unwinding imbalances – need for fiscal consolidation
- The Czech labour market: room for further improvement

All research publications can be downloaded free of charge from the DG ECFIN website: **http://ec.europa.eu/economy_finance/publications_en.htm**

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ISSN 1830-518-0
9 771830 518003