



*Economic Council
of the Labour Movement*

ABSTRACT

MOMENTUM FOR RECOVERY IN EUROPE PROMOTING PUBLIC AND PRIVATE INVESTMENTS: AN ASSESSMENT OF THE ECONOMIC EFFECTS

In the five-point plan "Momentum for recovery in Europe promoting public and private investments" suggestions are made on adequate funding instruments and financial support mechanisms to promote investments in Europe. The plan includes increased public investment by fully spending of the EU budget line, decrease of the European-wide interest rate, strengthening the contribution of the EIB to promote private investments and redirecting national public expenditures towards the Lisbon objectives.

In total the promotion of investments in Europe will increase growth and employment considerably. According to the calculations in this paper the initiatives will increase growth by almost 1 percent per year in the period 2005-2007 and additional almost 0,5 percent per year up to 2010. The effect can be even larger if the initiatives increase confidence in the private sector in Europe.

As the plan promote both public and private investment there will be no negative effect on the general government budget. Increased spending in the public sector is more than outweighed by increased public income from taxes and public savings from smaller expenditures on social benefits.

Up to 2010 the initiative will create 3,4 million jobs and when the effects are fully absorbed in the labour market the effect can be up to 4,7 million jobs.

**MOMENTUM FOR RECOVERY IN EUROPE PROMOTING PUBLIC
AND PRIVATE INVESTMENTS:
AN ASSESSMENT OF THE ECONOMIC EFFECTS**

The present scenario

In the medium term it is difficult to give a precise picture of growth and employment in Europe. The projection below is fairly positive. Table 1 illustrates our overall expectation towards growth, employment and other central economic variables from 2005 to 2010. These figures are the point of departure in the following calculations on the five point plan for recovery in Europe.

Table 1. Projection of the European economy, EU-15, 2005-2010

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	2,0	2,0
Total investments, constant prices	2,2	2,2
Employment	0,3	0,2
Private consumption deflator	1,7	1,7
	Level, last year in the period	
Unemployment rate	7,5	7,1
	Average	
General government balance, as a percentage of GDP	-1,9	-2,2
Interest rate, difference to the FED , percentage point*	0,5	0,5

Note: * ECB minimum bid rate.

Source: Projection by ECLM based on the international model "HEIMDAL".

According to table 1 our projection running to 2010 is fairly optimistic. We anticipate that the recession is over and that the average growth in GDP will be 2 percent per year. This means that employment will rise and the rate of unemployment will fall slightly.

The forecast includes a rise in exports in the coming years which result in a positive effect on the balance of payment.

Table 2 shows forecasts for the new member countries for 2005. It is expected that these countries will continue to catch up, and therefore have a significantly higher growth rate than the present EU member countries for several years. The catch-up growth rate is expected to be at least 2 percent point higher than growth in EU-15. The growth in investments are also significantly higher in these countries due to the fact that they face large challenges in building infrastructure and up-to-date technology in the private sector.

Another feature of these countries is that they face larger inflation than the present member countries and average public deficit exceeding the limit from the growth and stability pact. Both features characterise transition countries and are not worrying.

Table 2. Projection of the acceding countries, 2005

	2005
	Growth per year
GDP at constant prices	4,2
Total investments, constant prices	7,8
Employment	1,1
Private consumption deflator	3,1
	Level
Unemployment rate	14,8
	Average
General government balance, as a percentage of GDP	-4,1

Source: The European Commission, Economic Forecast autumn 2003.

A five-point plan for promotion public and private investments

In the five-point plan "Momentum for recovery in Europe promoting public and private investments" suggestions are made on adequate funding instruments and financial support mechanisms to promote investments in Europe. The plan includes increased public investment by fully spending of the EU budget line, decrease of the European-wide interest rate, strengthening the contribution of the EIB to promote private investments and redirecting national public expenditures towards the Lisbon objectives. A detailed description of the plan can be found in the paper referred above.

In total the promotion of investments in Europe will increase growth and employment considerably, cf. table 3.

Table 3. Total effect of implementing the five point plan. EU-15.

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	2,8	2,4
Total investments, constant prices	5,3	3,2
Employment	0,7	0,5
Private consumption deflator	2,1	1,9
	Level, last year in the period	
Unemployment rate	6,9	6,3
	Average	
General government balance, as a percentage of GDP	-1,7	-1,7
Interest rate, difference to the FED , percentage point*	0,4	0,2

Note.: It is assumed that ECB will keep a constant real interest rate (apart from the initial reduction by 0,5 percent points). This means that the ECB increase the interest rate when inflation increases. The rate on long term bonds will gradually follow the fluctuations in the ECB rate. The USD/Euro exchange rate will be influenced by changes in the interest rate.

Source: Calculations by ECLM based on the international model "HEIMDAL".

Table 3 illustrates that by promoting public and private investments in Europe, we can reach a growth rate of almost 3 percent per year on average in the first period. In the second period the extra growth is also considerable. How the extra growth and employment is distributed over the years depends on how and when the five point plan is implemented over the years. The immediately reduction of the interest rate, increase in public investments and other initiatives in public spending result in a larger effect the first years of the period than in the last years.

Table 4. Marginal effect of implementing the five-point plan, EU-15.

	2005-2007	2008-2010
	Percent point per year	
GDP at constant prices	0,8	0,4
Total investments, constant prices	3,1	1,0
Private consumption deflator	0,4	0,2
	Cumulated effect	
Employment, 1.000 employed	2.000	1.400
	Level, last year in the period	
Unemployment rate	-0,6	-0,8
	Average	
General government balance, as a percentage of GDP	0,2	0,5
Interest rate, difference to the FED , percentage point*	-0,1	-0,3

Note: The table shows the accumulated differens between table 1 and 3.

Source: Calculations by ECLM based on the international model "HEIMDAL".

In table 4 the marginal effects of the five point plan is illustrated i.e. the difference between table 1 and 3. The table show that in the first 3 years the plan will create employment for 2 million more people in EU-15, and in the last 3 years it will create an additional 1,4 million jobs. The effect of political initiatives on job creation is generally slower that the effect on growth. Therefore the total effect on employment will be even larger in the years following. When the effect is largest the initiatives will have created more than 4 million jobs in the EU-15 countries.

As it will be illustrated in a later part of the paper the effect on employment can be even larger if the additional effects from more confidence in the economy from the private sector is included. Table 5 illustrates the short run and long run effects of the plan on employment with or without additional confidence.

Table 5. Effects on employment - short run and long run

	2005-2007	2008-2010	Full effect
	Accumulated effect, millions employed		
Five-point plan	2,0	3,4	4,0
- With more confidence in the private sector	2,4	4,1	4,7

Note: The full effect is calculated as the effect in 2015 and 2014.

Source: Calculations by ECLM based on the international model "HEIMDAL".

With more confidence from the private sector the full effect on employment will be almost 5 million more employed. The timing of the effects on employment of course is a result of the economic model. Is it therefore not unrealistic that some of the effect can be put forward by labour market policy and other initiatives.

The government deficit

The overall effect on the general government deficit is positive, in a way that the deficit in the EU-15 countries is smaller with the five-point plan than without. On average the deficit is reduced by a bit more than 0,2 percent of GDP per year. Among other things this is caused by higher public income via revenue from taxed and social contributions combined with lower expenditure on social benefits.

The increase in public investments through fully spending of the EU budget contribute negatively to the government deficit because the national part of the investments are not financed in the calculations. On average the effect is a larger deficit by approximately 0,1 percent of GDP per year. The dynamic effects from the (financed) contribution from the EU budget and the larger growth and employment from the policy reduce the total negative effect on the public budget compared with the national contribution.

Some of the other initiatives in the plan - on the other hand - gives a positive impact on the public deficits. The reduction of the interest rate reduce the deficit by approximately 0,2 percent of GDP. Half of the reduction is caused by smaller interest rate payments on the public debt. It should be noted that even without the effect from the lower interest rate the effect on the public budget will be positive.

The rest of the elements in the plan; strengthening private investments via the EIB and redirecting national expenditures towards the Lisbon objectives also gives a positive contribution to the public budget by a bit more

than 0,1 percent of GDP. The contribution is largest in the end of the period because the implementation is assumed to happen gradually.

The new member countries

The economic model of the Economic Council of the Labour Movement is not yet able to calculate the effects on the acceding countries directly, but the effect of the plan will undoubtedly give a more positive effect on growth and employment for these countries than in the EU-15 countries.

This is because the public investments by fully spending the EU budget is relatively large in the new member countries because a relatively large part of the funds are canalised to Eastern and Central Europe. On an overall basis the investments by EU in the new member countries are increased by 6,5 billion Euro. And this amount is doubled by the national financing.

The large national financing (compared to the size of the economies) also means that the positive effect on the public budget is smaller for these countries. Another reason for this is that the public debt - and therefore the savings from reduced interest rates - is smaller.

The calculations assume that the effects from increased private investments and more focus on the Lisbon objectives in national public expenditure is distributed proportionally to the size of the economies. But it can be argued that the new member countries will be more attractive to private investors and therefore attract a larger proportion of the investments promoted and supported by EIB.

The calculations in detail

In the following it is presented how the five point plan has become operational in the model calculations. The plan is implemented from 2005 and onwards to 2010.

Point 1: Mobilising European financing resources throughout fully spending of the EU budget in line with the Lisbon objectives

The current European-wide spending limit of 0,8 percent of GDP is increased to 1,2 percent which is in line with the present financial perspective and the Lisbon objectives. The larger contribution to the EU is financed by an increase in the indirect taxes. In total the increase in European-wide public spending is slightly less than 40 billion euro (2002 prices).

The increased investments are distributed between all the member countries in a way that the less developed countries receive the most. This means that the new member countries receive a relatively large part of the extra European-wide public investments. All countries supplement the investments by national funding in the same scale. The national funding is not financed on the public budgets.

The national co-financing results in public investments which on average will increase by 0,8 percent of GDP. The investments are fully implemented from 2005 and forward.

Point 2: Further decrease of the European-wide interest rate

The minimum bid rate from the European Central Bank (ECB) is reduced by 0,5 percent points resulting in an interest rate which is on the same level as the interest rate of the FED. Also EU countries outside the EMU such as the United Kingdom and Sweden lower their interest rates.

The last couple of years the difference between the European and American short term interest rate has been larger than 0,5 percent points. But in our projection the American interest rate will rise more than the European and thus reducing the difference in the future.

Reducing the European interest rate increases private investments and private consumption in the EU, and also results in a slight depreciation of the Euro so that the European export is stimulated. On an overall basis the five

point plan increases domestic demand and thereby puts a pressure on the inflation because it increases growth and employment. As a reaction to the increasing inflation the ECB increases interest rates. The final result is that in the end there still is a difference between the European and the American interest rate - but the difference is 0,5 percent points smaller than it would have been without the initial reduction of the interest rate by ECB.

The decrease in interest rate has a positive effect on the European economy. But even without the reduced interest rate in the plan the growth in Europe will be affected positively. The reduction in interest rates contributes by approximately 0,1 percent extra growth per year.

Point 3: Strengthening the contribution of the EIB throughout full use of loan capacity

As of 31 December 2002, outstanding lending from own resources and guarantees from the European Investment Bank (EIB) amounted to 234 billion Euro. From 2003 the ceiling on loans has risen to 375 billion Euro. The calculations adapt the assumption that this ceiling will be reached by 2010, resulting in a gradual increase in lending by 22,5 billion Euro each year.

Some of the increase in lending is accommodated by reinforcing the advisory and technical support from EIB and by increased participation in risk-capital projects and SME's. This accounts for approximately 2/3 of the increased lending. The rest of the increase in lending is demand driven i.e. caused by larger private investments following the increased growth and optimism in the private sector resulting from the initiative. The increase in investments is assumed to be distributed according to the size of the economies.

Point 4: Redirecting national expenditures towards the Lisbon objectives

The Lisbon objectives include a number of initiatives which can facilitate growth and prosperity. One of the initiatives is a larger focus on education

and training which (among other things) results in a rising participation rate of the European populations. In the calculations it is assumed that there is a gradually increase in education and training by 2,5 percent up to 2010. Supplementing this it is assumed that other initiatives increase the participation rate even more. These initiatives could be better public service of child care to attract more women to the labour market, better working conditions, revision of pension systems and changing of tax and social benefit systems to increase the incitement to work. In total the European countries face an increase in the participation rate between 0,2 and 0,6 percent during the 6 years as a result of these initiatives.

All in all it is also assumed that the national governments increase expenditure on childcare, education and training and research & development. The increase in public spending in these areas amounts to a total of 2 percent. As the average expenditure on education is around 10 percent of the total public budget in the EU countries and the average public expenditure on childcare and research and development is somewhat smaller the total public spending is increase by 0,3 percent on average.

According to the Lisbon objectives the employment rate should reach 70 in 2010. This is not the case in our base scenario, where the employment rate is 66,5 in 2010. Even though the five point plan increase the participation rate and employment in Europe, the goal is not reached there either. In 2010 the employment rate is 67,8. In the scenario with more private confidence the employment rate is 68,1 in 2010. The effect which is lower than 70 is partly due to the fact that the employment rate is reduced this year and only face a small increase in 2002 and 2004. Thus the point of departure is not as good as one could have hoped, and therefore it will be extremely difficult to reach the objectives in 2010.

The redirecting of national expenditures towards the Lisbon objectives also result in better functioning labour markets. This means that the structural

unemployment will fall. In the calculations this effect is included by reducing the growth in wages by 0,2 percent per year.

Effect on the private confidence at European economy

The initialising of a plan to promote public and private investments resulting in larger growth and employment, properly will increase confidence to the economy in the private sector. For some years consumers and private investors have had large savings rates and low investment rates as a result of a pessimistic view towards the future. If these private actors gain larger confidence the result will be larger private consumption and larger private investments.

In table 6 the effect of the five point plan including larger confidence is illustrated. Thus the table shows the effects from table 3 plus effects from increased confidence. Increased confidence is implemented as an increase in the growth of private consumption by 0,1 percent per year and an increase in the growth in private business investment by 0,5 percent per year.

Table 6. Total effect of implementing the five point plan including increased confidence in the private sector. EU-15.

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	2,9	2,5
Total investments, constant prices	5,7	3,5
Employment	0,8	0,5
Private consumption deflator	2,3	2,0
	Level, last year in the period	
Unemployment rate	6,8	6,0
	Average	
General government balance, as a percentage of GDP	-1,7	-1,5
Interest rate, difference to the FED , percentage point*	0,6	0,5

Source: Calculations by ECLM based on the international model "HEIMDAL".

The table shows that the average growth in GDP and employment will be slightly higher, and that the effect on unemployment therefore also is

larger. The inflation is about 2 percent per year, and the general government balance is further improved due to the increase in confidence.

A co-ordinated policy

As stated as the last points in the five-point plan, it is crucial that the promotion of public and private investments is implemented co-ordinated in Europe. If the investment promotion is implemented non co-ordinated it will only have a limited effect. This is especially the case for the smaller countries in Europe.

The limited effect of a non co-ordinated implementation is illustrated in table 7 and table 8. The full effect (excluding the effect of for the increased confidence) of the five-point plan for the Netherlands is illustrated in table 6. That is, it is the effect of the same policy as shown in table 3, but only the resulting effect for one single country, the Netherlands, is illustrated. It is seen from table 7 that the average annual growth in the Netherlands will be just under 3 percent in the first period and about 2,5 percent in the second period. There is also an increase in employment and a falling unemployment-rate as a result of the policy.

Table 7. Total effect of implementing the five-point plan. The Netherlands.

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	3,0	2,5
Total investments, constant prices	5,4	3,3
Employment	0,6	0,3
Private consumption deflator	2,2	1,9
	Level, last year in the period	
Unemployment rate	3,0	2,9
	Average	
General government balance, as a percentage of GDP	-0,7	-1,5

Source: Calculations by ECLM based on the international model "HEIMDAL".

Opposite of the co-ordinated policy is the effect of the policy, if only the Netherlands is implementing it – i.e. increased public and private investments and a greater focus at the Lisbon objectives in the public consump-

tion in the Netherlands only. This effect is illustrated in table 8. It is clear from the table, that if only the Netherlands is implementing the policy the resulting growth will be significantly smaller. This is because the positive effect from the surrounding countries is missing. Another important issue is that the general government balance is worsened. This is again a result of the missing positive effect from the rest of EU.

Table 8. Effect of implementing the five-point plan in the Netherlands only.

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	2,3	2,2
Total investments, constant prices	4,7	3,2
Employment	0,1	0,0
Private consumption deflator	1,7	1,6
	Level, last year in the period	
Unemployment rate	4,1	4,6
	Average	
General government balance, as a percentage of GDP	-1,3	-2,4

Source: Calculations by ECLM based on the international model "HEIMDAL".

Even though the small countries in Europe benefits most from the co-ordinated policy, it is also important for the greater countries to co-ordinate the policy. This is illustrated by showing the effects of a co-ordinated and a non co-ordinated implementation of the policy in Germany. The total effect on Germany of a co-ordinated implementation is shown in table 9.

Table 9. Total effect of implementing the five-point plan. Germany.

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	3,0	2,3
Total investments, constant prices	5,4	3,0
Employment	0,6	0,4
Private consumption deflator	1,9	1,8
	Level, last year in the period	
Unemployment rate	7,0	5,8
	Average	
General government balance, as a percentage of GDP	-2,3	-1,2

Source: Calculations by ECLM based on the international model "HEIMDAL".

The development of the German economy is on the same lines as EU in total; annual growth-rates just around 3 percent in the first period and 2,5 percent in the second period, a significant increase in investments and an inflation at about 2 percent per year.

A significant lower annual growth-rate is the result if Germany is the sole country to implement the policy. The annual growth will be just under 2,5 percent in the first period and 2 percent in the second period. Also the effect on employment and on the unemployment-rate will be lower. And as was the case for the Netherlands, especially the general government balance is worsened when only Germany is increasing the public and private investments.

Table 10. Effect of implementing the five-point plan in Germany only

	2005-2007	2008-2010
	Average growth per year	
GDP at constant prices	2,5	2,1
Total investments, constant prices	4,8	2,8
Employment	0,3	0,2
Private consumption deflator	1,6	1,5
	Level, last year in the period	
Unemployment rate	7,7	6,9
	Average	
General government balance, as a percentage of GDP	-2,9	-2,2

Source: Calculations by ECLM based on the international model "HEIMDAL".