

**UNICE RESPONSE
TO THE COMMISSION'S RECOMMENDATION
FOR THE 2001 BROAD ECONOMIC POLICY GUIDELINES**

Introduction

The Broad Economic Policy Guidelines (BEPG) for 2001 reflect the deterioration in the international climate; the Spring forecasts revise down predicted growth for the EU to 2.8% (from 3.2% previously envisaged) in 2001, although this is expected to increase slightly again in 2002. This is broadly in line with revisions made by other international organisations, as well as UNICE's own estimate in the March 2001 Economic Outlook.

The Commission's Spring forecasts expect Europe to remain relatively isolated from the worsening in the international environment, for two main reasons. Firstly, trade linkages to the US are limited, so spill-over from a slowdown will also be limited. Secondly, the US recovery is expected to be relatively rapid, again limiting serious knock-on effects. Consumer confidence in Europe has remained robust.

This analysis is comforting for the European economy, but in UNICE's view, it might be overly optimistic.

Are there greater risks from the international situation?

The international situation could have more serious consequences for European growth:

- The transmission mechanism for economic slowdown might be the stock market, rather than trade. Spill-over between stock markets can be very rapid. A marked fall in stock market valuations is likely to affect consumer confidence in the EU;
- Furthermore, the US slowdown may have a large indirect impact on EU trade, by reducing demand for EU products in third countries, which have stronger trade relations with the US;
- The speed of recovery in the US is not clear. The macro-economic situation would appear to be substantially imbalanced: private saving is at an all-time low and both households and companies have high levels of debt, while the current deficit is at a record level;
- The economic situation in Japan remains poor, and risks spreading to the rest of East-Asia, which would affect EU growth prospects;
- Consumer confidence may also suffer locally as a result of necessary business restructuring.

While it is possible that these risks will not materialise, policy makers do need to be aware of them. UNICE believes the best preparation is to accelerate reforms, allowing the economy to respond flexibly to external shocks when they arise. This needs to be combined with a stable macro-economic framework.

The BEPG 2001

UNICE broadly welcomes the tone and content of the BEPG 2001. As before, they aim to combine stable framework conditions with further structural reform.

1. Some concerns remain, however, in terms of implementation.

- The risk of complacency in policy-making must be avoided. By presenting policy challenges as short-run (macro-economic policy mix), medium-run (structural reforms) and long-run (population ageing), the guidelines risk obscuring the importance of implementing further structural reforms and addressing population ageing now.
- Interlinkages between policy solutions need to be made clear to avoid the piecemeal introduction of policies. Examples are the reduced inflationary pressures that result from structural reforms, or pensions reform and budgetary consolidation.

2. The continued orientation towards **economic stability** is appropriate; it should be re-emphasised that a stable macro-economic framework is the best guarantee of positive growth performance in the future. It is also the best way to achieve the maximum gain from the structural reforms that are being introduced, or should be introduced.

3. **Sound public finances** are a key element of macro-economic stability. At this stage of the economic cycle, Member States should be running budget surpluses, which is not the case in most. The Stability and Growth Pact commits members of the euro-zone to seeking budget balance, or a small surplus, over the economic cycle. The necessary conditions for lower long-run interest rates, and hence more growth, will emerge if countries achieve this stability.

4. In this context, the current **institutional arrangements** for ensuring that economic policies are co-ordinated might be seen as insufficient to ensure the necessary discipline required for stability in euro-zone. Co-ordination relies almost entirely on peer review at the moment. Until now, this has been relatively successful. The question arises, however, how peer review can be effective and credible when several Member States, together accounting for a large proportion of euro-zone GDP, follow policies that are not consistent with common guidelines.

5. **Population ageing** in the coming decades will put severe strain on most economies in the EU. The BEPG disappoint by their failure to present a clear strategy for dealing with this problem. Member States must start taking a proactive stance. The longer a coherent response is postponed, the greater will be the ruptures caused in the coming years. No single policy measure will provide the solution; instead a combination of measures should be introduced. Governments must start planning for the extra pressure on their budgets, by further consolidating public finances, in order to cover future commitments already made. Pensions reform is also required, in particular by promoting the expansion of privately funded complementary pensions. At the EU level, the investment regime for occupational pension funds must be liberalised, to allow the effective cross-border operation of these. Hence, UNICE urges the Council of Ministers to clear the passage of the amended proposal for a directive on the activities of institutions for occupational retirement provision. At the same time, the average working-life needs to be extended, and structural reforms made to encourage greater labour market participation.

The ageing population also means European businesses will have to deal with a considerable reduction in labour supply, as working-age population declines. This highlights the importance of increasing labour market participation, on the one side, but also the need to raise productivity growth. To do so will require more flexible labour markets, improved education systems and greater emphasis on lifelong learning, as well as tax systems that provide appropriate incentives.

6. More generally, **government expenditure** needs to take explicit account of quality and value for money. Reform of government expenditure is required; in part expenditure needs to be redirected to investment in human and physical capital, to improve the longer term competitiveness of Member States. However, the link between the level of government expenditure and the tax burden must be highlighted. Only effective reform of government expenditure will allow excessive tax levels (or debt) to be reduced in the long-term. Several Member States have reduced taxes this year, a welcome move, but one that needs to be accompanied by appropriate expenditure reforms to be durable.

7. **Public administrations** must also play a more supportive role for business activity; administrative simplification should aim to enhance the ability of businesses to carry out all phases of their operations, helping them become more competitive. Benchmarking the activities of public administrations would provide an important stimulus to improvement.

8. In terms of **debt and tax reductions**, the BEPG 2001 call for “an appropriate balance and order” between paying down debt, cutting taxes and financing public investment. UNICE would reiterate that such a discussion must be underpinned by reductions in expenditure levels. How the resulting savings are then used will depend on the situation in individual Member States, however, it remains the case that tax levels are excessive in most.

9. UNICE welcomes the **ECB’s** recent decision to lower interest rates. Nevertheless, the ECB’s communication strategy could be improved, notably by acting more transparently, which would give its actions greater credibility. The BEPG rightly avoid criticism of the ECB’s interest rate policy. The euro-zone requires an independent and credible central bank in order to maintain low interest rates within a stable framework. Wage moderation and sound public finances are important conditions for this stability. Political pressure aimed at influencing interest rate policy will undermine the ECB’s credibility, and slow its responsiveness.

10. UNICE also welcomes the BEPG’s continued emphasis upon **structural reforms**. These reforms need to be accelerated, as well as more effectively benchmarked and monitored.

- **Labour markets:** Ambitious employment targets established at Lisbon and Stockholm require more flexible labour markets. High labour taxes and social charges still make it very expensive to hire workers in many EU Member States. Without a reduction in these costs, the employment-intensity of income growth will remain low. Of particular concern recently have been the defensive regulatory measures taken in Member States, in response to necessary business restructuring.

Labour market participation must be encouraged, by ensuring that tax and benefit systems – in conjunction – provide a more appropriate incentive structure, and by extending the activation of benefits, which has already been in evidence in some Member States. The Lisbon strategy included substantial emphasis on encouraging development of the New Economy in Europe. This initial impetus must not be lost now. Such a knowledge-based economy continues to play an important role in raising the productive potential of the economy as a whole.

- **The Single Market:** Completion of the Single Market must continue to be a priority, and again the BEPG correctly identify this. Artificial barriers that continue to segment many markets must be broken down. Progress has remained limited in a few key-sectors, above all energy markets, while public procurement remains highly biased towards national companies. Achievement of a single market for capital is a necessary counterpart of the Single Market for goods and services. UNICE urges the rapid introduction of the procedures set up in the Lamfalussy report, and the implementation of the Financial Services Action Plan as early as possible.
- **Sustainability:** The Stockholm Council asked that the promotion of sustainable development be integrated into the BEPG. In general UNICE welcomes the broadening of the debate on sustainable development to reflect the intrinsic relationships between economic, social and environmental aspects. However, the economic pillar must be seen as the basis and prerequisite for the other two pillars. The BEPG focus on the integration of environmental aspects into economic policy, in particular the use of market-based instruments (including taxation). UNICE urges that any policy tools should be constructed and used in a way that ensures a level playing field in relation to markets and competition and does not create distortions of international trade and competitiveness. Economic actors should have a central role in the EU dialogue on sustainable development.

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