ECONOMIC OUTLOOK

OCTOBER 2001

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The UNICE Economic Outlook provides a business insight into recent economic developments, based on a survey of national member federations covering all 15 Member States of the EU. Qualitative data and forecasts were established in September 2001. Aggregate values are GDP (at PPS) weighted, unless otherwise indicated.

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Table 1: UNICE forecasts

EU-12	**2001**	**2002**
GDP (annual % change)	1.9	2.3
Inflation (%)	2.8	1.7
Unemployment (%)	8.4	8.3
Employee Compensation (annual % change)	3.2	2.9
EU-15	**2001**	**2002**
GDP (annual % of change)	1.9	2.3
Inflation (%)	2.5	1.6
Unemployment (%)	7.7	7.6
Employee Compensation (annual % change)	3.5	3.2

SUMMARY

- **Forecasts of growth in Europe have been significantly revised downwards**
- **The business climate has deteriorated markedly in the past six months – it is now strongly negative**
- **The international climate – especially the US – continues to pose a considerable threat**
- **Regulations that restrict the labour market are increasing**
- **Labour markets are becoming less tight**
- **Employment in industry will fall; there is more optimism in the services sector**
- **Budgetary consolidation is an objective in most member states, but achieved by fewer**
- **Pensions reform remains necessary for the stability of public finances**

Terrorist attacks upon the US

The fatal attacks on New York and Washington on 11 September are first and foremost a human tragedy. The loss of life simply outweighs all other costs.

Assessment of the economic cost cannot be made with any reliability at this moment. We do not know how the economy will respond.

The immediate material cost of the attacks is not sufficient to derail the US economy as a whole.

The knock-on effects are economically much more important – and much more uncertain. Consumer confidence in the US has been the main reason for the continued strength of the US economy; industrial confidence, in contrast, has been very low, but showing some signs of revival. The most recent figures, however, suggest that even consumer confidence in the US had slowed down markedly before the attacks. There is the clear risk that consumer confidence in the US will now be eroded sufficiently to entail a full-blown recession. Stock markets have displayed some signs of loss of confidence in the immediate aftermath of the attacks. This may – or may not – be reflected in the response of consumer behaviour.

The fundamentals of the US and European economies have not changed as a result of the events of 11 September. This needs to be made clear. Consumer confidence is determined by psychological factors. On the positive side, we know policy-makers in the US, and in the EU, have some room for manoeuvre in the event of a steep downturn in consumer spending. The Federal Reserve and the ECB have already shown awareness of how fragile the economy is at the moment; in the immediate aftermath of the attacks, they also provided the necessary liquidity to avoid systemic collapse of the financial system.

Introduction

As in previous editions of the UNICE Economic Outlook, the main source of data are the business and industrial federations of EU Member States. The main purpose of the publication is to provide a clear picture of the current business climate in Europe, and the trends that emerge.

Forecasts

The estimates for growth presented in this report were made before 11 September; they have not been updated. While the attacks will certainly have a negative effect, the uncertainties surrounding the magnitude of the effect, mean that any estimates would be of limited value. The figures should be seen as growth expectations in early September 2001.

In early September, UNICE's member federations expected growth in 2001 to average 1.9% in the EU, and only 2.3% in 2002 (figures for the EU-12 and EU-15 are the same). This is a significant reduction from the figures expected six months ago. The economic outlook was already worse than might have been hoped before the attacks in the US. Six months ago, UNICE forecasts for 2002 were in line with those of the IMF, OECD and the European Commission.

The IMF has recently confirmed that its 2002 growth forecast for the euro-zone will be revised down from 2.8% to 2.4%. The Commission has made clear that it now expects growth to fall below 2% this year, and its forecasts in autumn should reflect this revision.

Businesses in the EU and elsewhere have clearly suffered, with almost daily reports of profit warnings and lay-offs and stock market volatility apparently increasing.

Expected figures for inflation and wage growth have also been revised down by member federations, although to a lesser degree than growth. In contrast, the projected unemployment figure remains in line with that expected six months ago, just below 8% for the EU-15, and slightly higher than this for the EU-12.

Overall, a significant slowdown in growth will be in evidence for the year 2001, although a renewed acceleration is expected for next year, with rates exceeding 2% again.

Economic climate

The last UNICE Economic Outlook in March 2001 highlighted considerable concern in the business community, in particular as to the extent of slowdown in the US, and the speed of recovery. Business confidence had already started to decline following the March 2000 Economic Outlook.

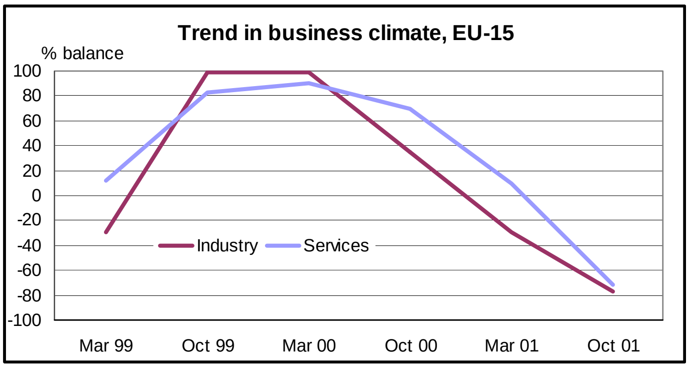
Recent evidence on the extent of slowdown in the US – even before the terrorist attacks – suggests that the situation is worse than originally thought, and it remains optimistic to expect a rapid recovery there. In spite of nine interest rate cuts by the Federal Reserve this year, the economy has apparently remained delicate.

At the same time, the situation in Japan has taken a turn for the worse, and the economy appears to be heading for recession.

In this context, it is not surprising that the business climate in the EU has continued to decline since the last survey was carried out. The balance of expectations – the share of weighted replies expecting an improvement in the next six months, compared with the share expecting a deterioration – is now strongly negative for both services and industry. In the service sector, the balance is negative by over 70%, while in industry the figure is even more negative, reaching almost 80%. This is by some margin the worst outcome registered since the UNICE Economic Outlook began. It aptly summarises the economic climate as perceived by business at the moment.

Within individual countries, the climate for industry is expected to worsen in all except Italy, Austria and Greece, where no serious slowdown is expected. The main culprit is the slowdown of the international economy, and reduced export demand, which was cited by all member federations, although in Greece consumer demand is expected to remain strong. Domestic demand for industry is also expected to decline in several, including Germany, France, Italy, while Ireland's high recent growth rates look set to fall sharply. Finland is suffering the slowdown in the IT-sector in particular. Spain and Ireland are facing a situation of industrial overcapacity.

Chart 1

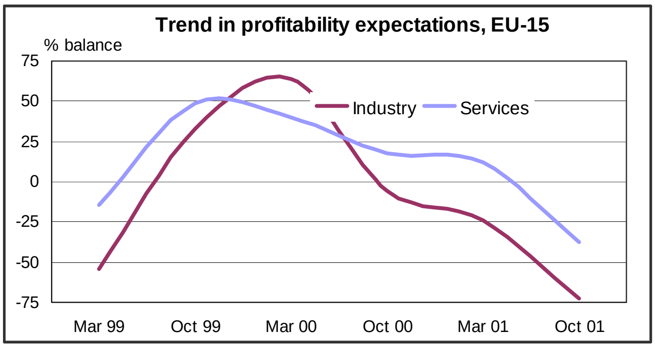


Balance charts show the difference between weighted shares of respondents expecting positive developments over the next six months and those expecting negative developments. Changes in this balance can be followed at six-monthly intervals from March 1999, when this survey was first carried out, to October 2001, giving an indication of the trend.

In the service sector, most member federations expect the climate to worsen, except in Austria and Finland where it should improve (due to purchasing power improvements), and Italy and Greece, where no change is expected over the next six months. In Greece the outlook is positive for most service sectors, with only the tourism sector really expected to suffer.
Main fears expressed in terms of the service sector include the spill-over from the industrial slowdown, or economic slowdown more generally, in Spain, France, Germany, the UK, Sweden, the Netherlands, Finland and Portugal. In Ireland the business sector is slowing, while consumer spending (excluding cars) remains relatively strong.

Thus the business community now has a strongly negative view of the economic climate that is expected over the coming months. In the March 2001 UNICE Economic Outlook, there was considerable optimism that consumer spending would remain buoyant, so maintaining economic conditions. This no longer appears to be the case. European business is bracing itself for a downturn in the coming months.

Chart 2



Profitability expectations for the next six months closely mirror the trend in the business climate, as might be expected. The balance of opinion on the trend over the next six months is clearly negative. For industry the balance has been negative since October 2000, while for services this is the first time the balance has gone negative since March 1999, when profitability was recovering. As with the business climate in general, the situation is markedly worse in industry than in services.

A positive trend in profitability over the next six months is expected in Denmark, and only for services in the UK (and even this is forecast to decline), while profitability in industry should follow a negative trend.

Among the other member federations, a negative trend in profitability is expected in industry everywhere, except Spain and Italy, where no change is expected. This results in the weighted balance of opinion are more than 70% negative.

In services, the weighted balance is 35% negative. As for industry, no change in profitability is expected in Spain and Italy, as well as in Austria, Finland and Greece. This leaves the remaining member federations expecting a negative trend in profitability.

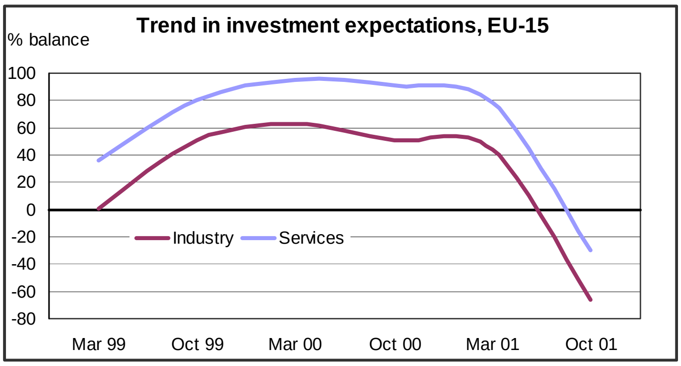
In addition to a general slowdown in demand, several other factors explain reduced profit expectations; these include low productivity growth in Germany and Austria, downward pressure on prices, notably in the UK and Luxembourg, and high wage demands in the Netherlands, Ireland and Luxembourg. In Spain employment adjustments will protect profit margins to some extent.

The balance of opinion for the expected trend in investment over the next six months is also negative, for the first time since the UNICE Economic Outlook started. The picture is again less negative for the service sector than for industry; in industry the balance is over 65% negative, while in service it is 30% negative.

The contrast with the balance of opinion just six months previously is striking. In March of this year the balance of opinion was positive, by over 40% in industry, and almost 80% in services. This gives some indication of the shift in the climate that is currently being experienced.

Since investment expectations lag behind the trend in the business climate, a further decline in investment expectations is to be expected.

Chart 3



Most member federations now have a negative view of investment expectations in industry over the next six months, as the economic slowdown has weakened demand and reduced capacity utilisation. The exceptions to this pattern are Finland, where no change is expected, and Italy and Luxembourg, which are expecting an upward trend. In Italy this is mainly due to inventory accumulation during the first quarter of the year, and expected government incentives, while in Luxembourg large investments aimed at modernising production facilities are expected in spite of the slowdown.

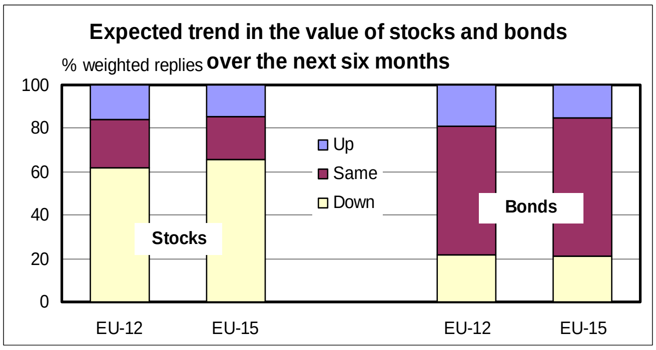
In services the situation has held up slightly better than in industry; six federations – Germany, France, the Netherlands, Belgium, Ireland and Denmark – have a negative view of investment prospects. The UK, Austria and Finland, in contrast, are expecting an improvement in the investment climate, while the remaining federations are not expecting any change. In Sweden there is still considerable concern regarding the repayments of 3rd generation mobile investments, which have already been rescheduled.

Six months ago, the UNICE Economic Outlook noted a deterioration in the business climate, which was closely linked to concerns about the extent and duration of a slowdown of the US economy. Since then the economic conditions have not improved, and hopes of a rapid recovery look misplaced. The terrorist attacks upon New York and Washington may dent consumer confidence, at

least temporarily. The upshot is a business climate that is substantially negative in Europe at the moment.
Growth estimates for 2002 have also been revised down significantly, both by the UNICE member federations and international organisations.
The European economy is now faced with a severe test of its ability to respond positively. Governments need to focus on creating the conditions for investment and growth. On the macro-economic level this means ensuring a stable framework for decision-makers. On the micro-economic level continued efforts are needed to free up markets, and allow market forces to work.

Stock markets and bond markets

Chart 4

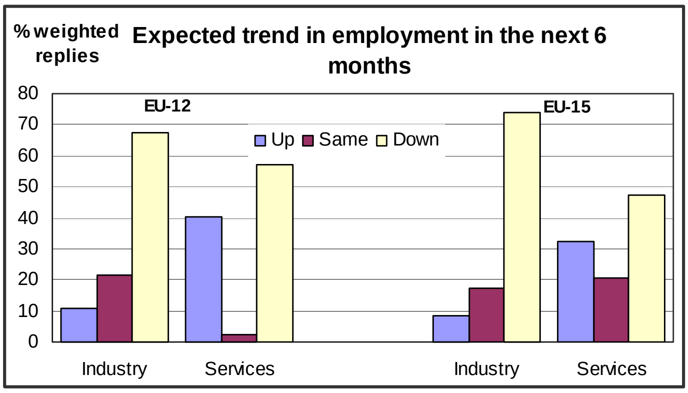


The negative economic climate has implications for the trend in stock and bond markets. This survey considers the direction – but not the magnitude – of expected changes in the prices of stocks and bonds. It is remarkable that around 60% of our (weighted) replies expect the value of stocks to go down in the next six months. Only a handful (just over 10%) expect prices to rise. Bond yields should be considerably more stable in the coming months; well over half expects bond yields to remain the same, and the shares expecting a rise or a fall in bond prices, are similar. Nevertheless, the prices of stocks and bonds yields will be among the first to provide an indication of economic uncertainty as the US attempts to get back to business.

Labour market and wage indicators

Employment developments were fairly positive in the year 2000, a growth rate of 2% pushing the employment rate to over 63% for the EU as a whole. Nevertheless, as the economic upswing of the past few years appears to be coming to an end, unemployment still stands at over 8%. An unemployment rate that bottoms out at 8% is not acceptable, and policy should continue to focus upon appropriate measures to increase the employment rate in Europe.

Chart 5

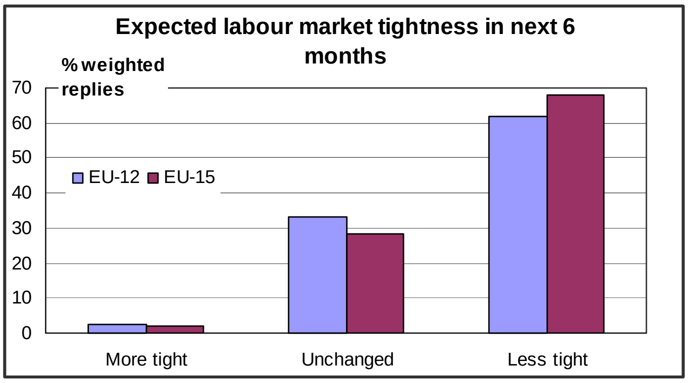


Two broad messages emerge from the opinions of UNICE member federations on the expected trend in employment over the next six months. In industry, the trend is clearly for a further decline in employment, among both the EU-12 and the EU-15. In services, the picture is less clear-cut, although the weighted share expecting a decrease still exceeds that expecting an increase in employment.

Looser labour markets?

Considering the slowdown in economic growth, which entails lower employment growth, or even a decline, it is no surprise that the labour market is expected to become less tight by a large majority of member federations, as many as 70% of weighted replies among the EU-15, and only a little less among the EU-12. Only in Greece is the labour market expected to become more tight over the next six months – due to a new law making overtime work more difficult and expensive. This stands in contrast to the results of our last Economic Outlook, where almost 40% of weighted replies expected the labour market to tighten. This again provides an indication of the extent of the slowdown.

Chart 6

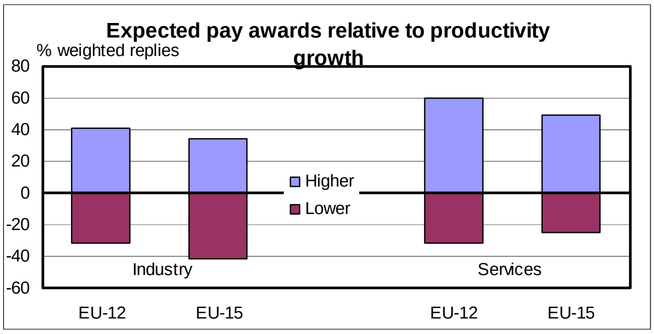


In the German labour market we observe both a looser labour market, due to the economic slowdown, and simultaneously, skills shortages remain in many branches. This would provide some rationale for the looser labour market in evidence above, and the relatively high pay awards that are reported below.

The wage effect?

In spite of the slowing economy and a looser labour market, many federations are still expecting pay rises to exceed productivity growth (discounting for inflation). Chart 7 summarises the weighted shares expecting to make pay awards that are higher or lower than productivity growth. In industry, the shares expecting higher or lower awards are similar. Services again stand in contrast; here the share expecting pay awards to outstrip productivity is clearly larger than that expecting pay awards to fall below productivity growth.

Chart 7



This can be seen as symptomatic in some sense of the labour market problems that need to addressed in the EU. As the demand for labour falls, there is a considerable lag before pay awards adjust. This is particularly the case in the services sector, where pay awards are expected to exceed productivity growth in seven member states. In none of these is the labour market expected to tighten. In France and the Netherlands, it is expected to be looser, while in Italy, Spain, Denmark, Austria and Luxembourg, it is expected to remain the same.

Furthermore, at the end of a period of sustained growth, unemployment remains high. This suggests a mismatch between supply and demand of skills in the labour market.

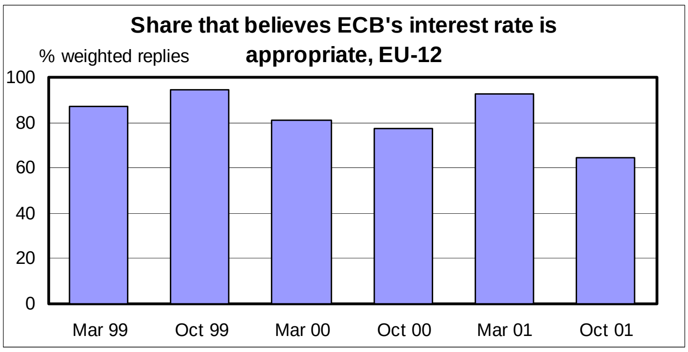
In France pay awards were generally settled at the same time as the negotiations on the 35-hour week. This has left the expected pay award above the rate of productivity growth. Measurement of productivity growth in France is complicated by the shift to the 35-hour week, which has resulted in limited productivity growth when measured on a per person basis, but high growth when measured per hour actually worked.

Short-term employment prospects are not ideal. The policy objectives should not change in the face of these difficulties. An increase in the employment rate will still necessitate actions to increase the labour supply, and to ensure continued wage moderation. We must also improve the quality of the labour force, notably through a continued emphasis upon lifelong learning. This should allow the available labour to be better adapted to the available jobs. Reforms of social security systems similarly remain a necessary part of the policy response; their scope should increase from the provision of a safety net, to become an active policy that represents a springboard back into employment.

Financial and monetary aspects

Member federations are asked whether they feel interest rates are appropriate (rather than too tight or too loose) at the time of the survey. We should note that practically all answers to this question were received before the rate cut by the Federal Reserve and the ECB on 17 September. Prior to September, the ECB had twice lowered interest rates in euro-zone in the last six months, in response to the worsening economic climate.

Chart 8

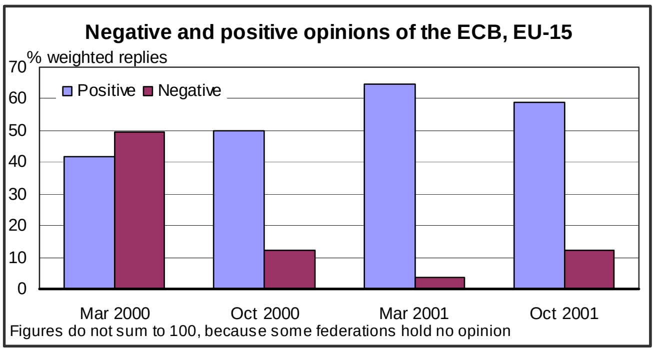


It is clear from the graph that the ECB's interest rate policy is thought to be appropriate by the great majority of member federations. Since March 1999, the share holding this view has generally been around 80% or more, reaching well over 90% in some instances.

The figure for October 2001 is relatively low in comparison with earlier figures; just under 65% feel that the interest rate is appropriate. This result needs to be considered in conjunction with the evidence on how the ECB is perceived, which is presented below.

Member federations have been asked their opinion of the ECB only since March 2000. In the graph the weighted shares holding a positive or a negative view (but not those with no view) are presented. It emerges fairly clearly that the share with a positive view of the ECB has increased since March 2000. Over the same period, the share with a negative view has declined dramatically. This share was initially greater than the share with a positive view.

Chart 9



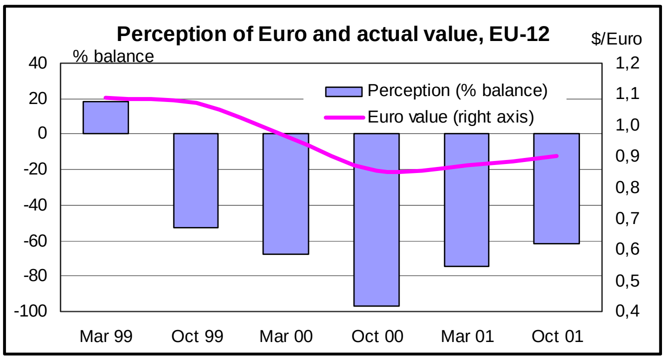
Although this could be interpreted as a broad endorsement of the ECB's performance, this comes with a considerable caveat – its communications policy.

Communications were highlighted in the last UNICE Economic Outlook as a problematic area. Even those who have a positive view of the ECB overall, point to communications problems. The interest rate adjustment in May is an example of this – it was felt by most observers to have surprised the markets, and the explanation given for the change was not clearly understood. Member federations in Germany, Finland, Spain, Ireland, Belgium and Portugal all note that communications have been insufficiently transparent. On the other hand, in the Netherlands and Finland it is felt that the communications policy has improved over recent months. This explains why federations are more likely to approve of the interest rate policy, than of the ECB overall.

The value of euro and its perception
The value of the euro has increased slightly relative to the US dollar in recent months, reaching a level of around 90 cents. It remains well below its launch level.

The great majority of UNICE member federations still perceive the euro to be undervalued. The balance of opinion indicates that the weighted share considering it undervalued exceeds that considering it overvalued by 60% among the EU-12. Broadly speaking, this share has been fairly constant over time, apart from in October 2000 – when the euro fell as low as 85 cents and the balance thinking it was undervalued reached almost 100%.

Chart 10



Budgetary policy in member states

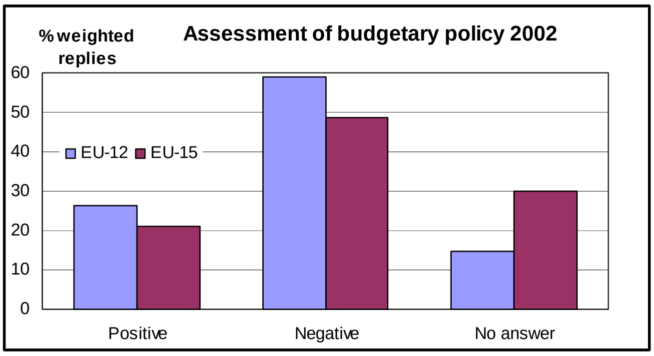
Budget deficits in Europe have fallen to low levels in most member states. In part this is due to the emphasis upon fiscal consolidation in European policy-making. This has made a very useful and welcome contribution to sound management of public finances. At the same time, there has been relatively high economic growth over the past few years in Europe, which has also made a strong contribution to public finances. This should not be confused with sound management. Several member states are still running deficits at the end of this period of growth. As was noted in the last Economic Outlook, the improvement in public finances in some countries depended upon the inclusion of receipts from the sale of assets (UMTS licences, in particular) as part of current income. In others, the move towards consolidation was achieved by increased taxes, rather than the necessary expenditure reforms.

In this issue of the UNICE Economic Outlook we take a closer look at public finances.

Budget policy in general is positively regarded by only around one quarter of weighted respondents in the EU-12, and by even less for the EU-15. This represents a significant decline in the positive share compared with the figure six months ago.

Among those holding a negative opinion, France notes that reforms have been too timid, and the government has failed to stabilise expenditure. Similarly, in Germany there has also been inadequate consolidation of expenditure. Where reductions in public expenditure have occurred, these have failed to seriously address current expenditure, and instead reduced investment expenditure. In the Netherlands there is insufficient determination to reduce the tax burden, while in Portugal proposed reforms to property taxes have been postponed beyond the beginning of 2002, and current expenditure remains high. In Ireland there have been large increases in public expenditure.

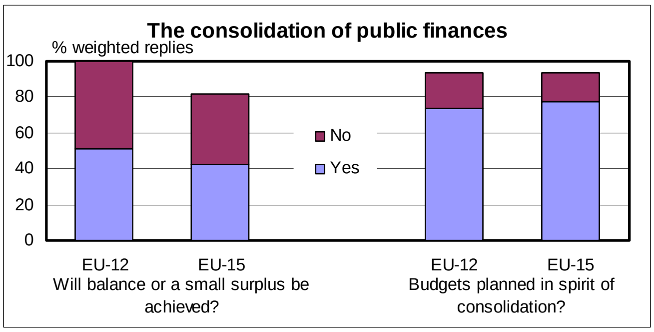
Chart 11



Developments are more positive in several other member states; for both Finland and Luxembourg reductions in taxes on employers and individuals are reported. In Italy the new government appears keen on structural reform in the aim of reducing taxes. In Austria the deficit is expected to be eliminated during 2002. In Greece, limited expenditure and tax cuts are positive steps, but further effort will still be required.

The Stability and Growth Pact includes the specific objective of balancing public finances over the medium-term, or running a small surplus. This essentially asks governments to run consolidated budgets, that are at least balanced over the economic cycle. Can we expect this to be achieved?

Chart 12



When asked whether their governments will achieve this balance – or small surplus – over the medium-run, replies are fairly evenly split. The (weighted) share that thinks their government will fail to achieve this objective is slightly larger than that believing it will be achieved. (Again, not all member federations felt able to reply.) The difference between the two shares, however, is not large, both among the EU-12 and among the EU-15. It deserves to be emphasised, however, that less than half think their governments will manage to achieve balance or surplus in the medium-run.

Balance looks likely to be achieved in several member states, most notably Finland, where a surplus of 4% of GDP is expected in the medium-term. Answers are also positive in Italy, Spain, the Netherlands, Belgium, Austria, Ireland (although continued high expenditure will put this in doubt), Greece and Luxembourg. In the UK the deficit target appears to be around 1.1% of GDP in the medium-run, which the government sees as close enough to balance. In both Germany, where progress towards consolidation has slowed down, and France, balanced public finances are looking unlikely in the medium-run.

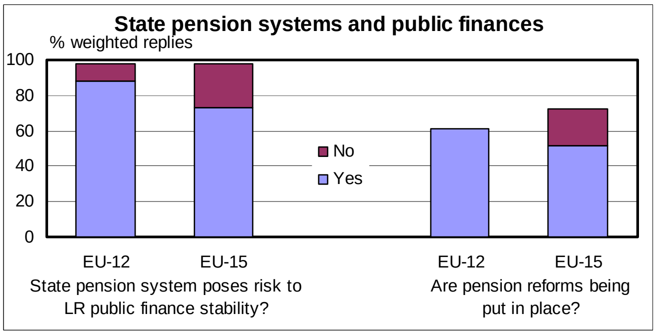
Nevertheless, there remains a considerable gap between government intentions, and their actions in practice. This highlights the importance of politics in the execution of economic policy. A supplementary question was asked, to identify how many believe their government finances are planned in the spirit of achieving budgetary consolidation. Over 70% believe finances are planned in this spirit. The results suggest that a considerably larger share of governments appears to aim for a consolidated budget, than actually achieves this. On a more positive note, it also suggests that the mindset of policy-makers in Europe is tending to accept the importance of sound budgetary management.

In Spain sound budgetary management has been a policy priority and looks likely to be achieved. In Germany public expenditure will increase more slowly, and shift towards investment, setting the path for sound management. In France, in contrast, budget consolidation is proclaimed as an objective, but not sufficiently backed up with actions. Similarly, in Portugal, a deficit of only 1.1% is projected for this year, but is unclear how this will be achieved. Greece also seeks sound budget planning, but more effort is needed in practice.

In Denmark public finances appear to be soundly managed in the short-run, but longer-run problems remain unresolved. This is due to the projected decline in the labour force, while the public sector is expanding – although the public pension system as such should not represent a source of instability for future public finances.

The problem of population ageing, and its impact upon public finances, remains of considerable concern. At the heart of the problem lies a substantial change in projected dependency ratios, and the fact that public pension systems in Europe are generally unfunded. This risks putting public finances on an unsustainable path.

Chart 13



A large majority of weighted replies believes that the state pension system risks undermining the stability of public finances in the long-run. Amongst the EU-12, over 85% (weighted share) believe this to be the case, while amongst the EU-15, the share stands at over 70%. This again highlights a problem that has been evident for some time. The projected population changes are not new, and neither are their implications for public finances. This is a long-term problem, however, and policy-makers have often proved unwilling to make the necessary reforms in the shorter-run.

Five member federations report that population ageing will not undermine the stability of public finances. These are the UK, the Netherlands, Finland, Denmark and Ireland. In the latter, the demographic situation is not a problem, while long-run provision amounting to 1% of GNP is in place. In the Netherlands this is mainly thanks to reforms made towards a funded system, including transforming the widespread early retirement schemes into funded pre-pension schemes. In Finland public pensions systems are already partly funded; nevertheless, reforms are being undertaken to improve the footing of pension systems. Early retirement schemes are being addressed through a high-level committee which is about to report; its aim is to raise average retirement age from 58 to 60 or 61. The method for calculating pensions is also under review.

Pension commitments do risk undermining the stability of public finances, however, in four of the big five member states (excluding only the UK), as well as in Sweden, Belgium, Austria, Greece and Luxembourg.

In Italy there were reforms in 1992 and 1995, aimed at shifting the system from a defined-benefit system, towards a contributive system (although still pay-as-you-go). The slow pace of these reforms means that the pension system will remain in deficit for the next 30 years.

In Germany, Sweden and Luxembourg there have been moves towards funded pensions. The actual pension was reduced in Germany, while in Sweden a closer link between pension and contribution was introduced. Nevertheless, these reforms remain insufficient to deal with the problem.
In Austria the age for early retirement has been increased by 18 months, but more reforms will be required; in Belgium, reforms have increased the retirement age for women.

In France the pensions system is not being reformed, in spite of the risk it poses to the stability of public finances.

Population ageing represents a serious challenge to the stability of many member states in the long-term. The impact of population ageing is now well-known, so further procrastination is inexcusable. It has become apparent that the reforms – if any – have been insufficient so far. Europe's economies are sufficiently integrated for this to be a concern for the whole of Europe, since instability in some countries will certainly spill over into others.
The problem can still be overcome, but reforms need to be started urgently and with conviction. These reforms will have to address several policy fronts – including both the labour market and the financial market, in addition to the actual state pension system.
UNICE will be presenting a strategy paper on pensions reform later this year.

Policy: BUDGET CO-ORDINATION IN THE EU

There has been considerable debate recently regarding the rules on public finances enshrined in the Stability and Growth Pact (SGP). These state that:

- budget deficits must not exceed 3% of GDP (apart from in given exceptional circumstances)
- public finances should display balance or a small surplus over the medium-run (interpreted as the economic cycle)

Since the start of monetary union, the ECB has been setting interest rates for the whole euro-zone, but each member state remains responsible for its own fiscal policy. There is considerable spill-over between the economies in the euro-area; inappropriate fiscal policy in one member state will have implications for all member states.

The SGP is an important instrument for ensuring an appropriate mix between monetary and fiscal policy. This is a pre-condition for a stable macro-economic environment. Without such stability, investment will suffer – reducing the current rate of economic activity, but also reducing the potential growth rate of the economy and employment.

Within the framework of the SGP, annual budget deficit targets are established for each member state. UNICE advocates a **strengthened co-ordination of budgetary policies** in member states, in order to achieve sound – or consolidated – budgets. Fiscal consolidation contributes to lower inflation, and supports credible monetary policy. Ultimately this allows for lower long-run interest rates, stimulating investment and growth. A consolidated budget implies public finances that are in balance over the economic cycle.

Budget consolidation is the most effective, and least disruptive, way to allow the automatic stabilisers to do their work.

In several member states, however, there has been insufficient progress towards consolidation. Although no member state is currently close to breaching the 3% deficit limit of the SGP, several look likely to miss their annual deficit targets. Estimates of structural deficits – excluding the effect of automatic stabilisers on the deficit – make clear that budget consolidation is still some way off. In several the structural deficit is currently large enough to risk violating the 3% deficit limit once the automatic stabilisers of a normal slowdown set in.

Member states should not deviate from the objective of achieving balance – or a small surplus – of public finances over the economic cycle. This is the key target set by the SGP. The Council should be consistent in issuing recommendations when these targets are missed.

The most appropriate way to measure progress towards budget consolidation is with structural deficits. Unfortunately, this is not a realistic option at the moment:

- Firstly, the measurement of structural deficits is complex, and reliable data are not available yet. UNICE encourages further moves towards establishing **timely and comparable data on structural deficits** at the European level.
- Secondly, any reformulation of the SGP would send the wrong signal to the markets, and **undermine the credibility** of the consolidation effort, and the fiscal framework in general.

Pressure should be applied **more effectively** to hold member states to their commitments under the SGP. Enhanced communication mechanisms are one step in this direction. Continued **monitoring** of how far member state budgets are consolidated will also be necessary.

Experience clearly suggests that increases in public expenditure to counter the economic slowdown will not be reversed during the upturn, thus leading only to greater deficits, or higher taxes, in the medium-run.

Population ageing adds a further dimension to budgetary consolidation; unfunded state pension schemes are set to come under great pressure in the coming decades, as populations in all member states become greyer. As noted above, reforms have been inadequate in the face of this problem. One element of the policy response is to avoid ruptures in public finances, by building up spare room for manoeuvre in preparation for this pressure. Unless the long-run sustainability of public finances is assured, there is a risk to economic stability in Europe; as such it should be subject to clear and **objective monitoring** at the European level, and included in the SGP.

In conclusion, UNICE calls for several elements to improve economic policy-making in Europe:

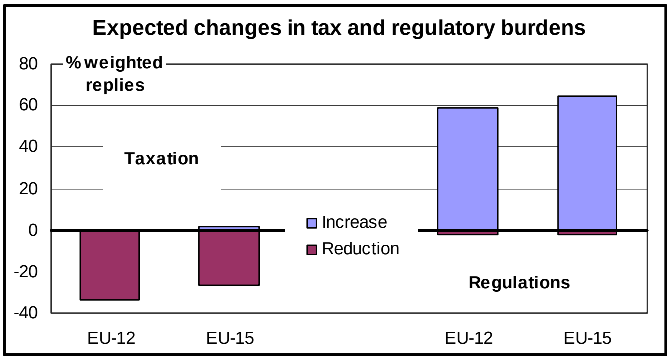
- **Clear commitments by all member states to consolidate public finances**
- **Close monitoring of progress**
- **More effective co-ordination and enforcement**
- **Provision of comparable and timely data on structural deficits**
- **Explicit inclusion of targets for long-run sustainability of public finances in SGP**

Tax and regulatory burden

Tax and regulatory burdens combine to hinder the progress and dynamism of European industry. It has for some time now been widely acknowledged at the European level that these need to be kept to a minimum. It should be noted that this applies not only to the amount of taxes or regulations, but also to their complexity, since both will serve to stifle business growth.

The results from the member federations are surprising because they highlight an apparent divergence in the way governments are handling regulations and taxes. The tax burden in Europe is not expected to increase (the only exception to this is Denmark, where an increase is expected).

Chart 14



Around one third of weighted replies expects the tax burden to fall over the next six months in the EU-12, and over one quarter in the EU-15. The corporate tax rate in Portugal will be reduced by two percentage points in January next year, from 32% to 30%. In the Netherlands this will be cut by a ½ percentage point cut, in addition to a slight decrease in social premiums. In Ireland, corporation tax levied on the non-manufacturing sector will be reduced by 4 percentage points, in order to reach a level of 12.5% by 2003 (to eliminate manufacturing's sectoral advantage). In Greece the corporate tax rate will also reduced in the next six months. In Finland, employers' social charges will be reduced, by 0.5%, in March. In Luxembourg tax reductions are expected as part of reforms next year.

The regulatory burden, in contrast, has declined in only one member state – in Greece, where red tape for starting businesses has been cut – in the past six months. Even here much more effort needs to be made, in particular making the public sector more business-friendly. The regulatory burden has increased in just under 60% of cases in the EU-12, and in slightly more in the EU-15. Where the regulatory burden has increased, it appears to be especially focused upon the employment field. In Germany and Portugal new restrictions upon temporary employment contracts have been introduced. In Germany this is accompanied by increased rights to work on a part-time basis, and a tightening of co-determination. In Portugal companies are now also obliged to withhold and transfer trade union contributions directly out of the wage packet, if requested. In France the 35-hour working week has had a significant impact, and a *loi de modernisation sociale* has also been introduced (as well as the NRE law). In the Netherlands legislation is being prepared to restrict Sunday working. Finally, in the UK there is general concern at a range of measures introduced, most of which are in the labour market.

Thus it is clear that governments are still active in many countries in terms of new regulations, which make the business climate more difficult for businesses to work in. Job creation is still being inhibited by the introduction of restrictions on flexible forms of employment, although these have been the largest sources of job growth in recent years. In terms of taxation, the tendency to increase the burden appears to have been halted for the time being, and in some countries tax cuts are being introduced. They need to be accompanied by efforts to make labour markets more flexible, with fewer regulations and restrictions on employers.

Main risks over the next six months

The greatest concern over the next six months is without doubt the possibility of a global slowdown, and in particular the state of the US economy. Pivotal to this will be the impact of the terrorist attacks in the US upon the US economy, and upon international climate and global stability in general. At this point it is simply too early to predict with any confidence what this impact will be. Nevertheless, the possibility of recession in the US represents a significant concern for businesses in Europe.

Several member states are also worried about the damaging impact of a rise in energy prices in the near future, notably Germany, Austria, Ireland, Belgium, Greece, Ireland and Portugal. For the time being oil prices appear to have stabilised, taking away from the immediacy of the problem.

Large or rapid changes in the value of the euro – which is accepted by most to be undervalued – also represent a source of concern, notably in Italy, Finland, Belgium and Luxembourg. For the UK, in contrast, an appreciation of sterling against the euro is a concern.

Several Member States will also be holding elections in the course of the next year, which might have implications for business prospects in general, as well as for their public finances.

Individual member federations also highlighted several other factors that may be important over the next few months:

Further turbulence or declines in financial markets and stock market are viewed as potential negative influences on the economy in Germany, Italy, Greece and Luxembourg.

In Belgium wage costs are increasing more rapidly than those of its main trading partners. Austria and Portugal also express concern about rapid wage rises.

The tax reform in Germany may improve domestic demand, as might the improved price climate. An easier monetary policy would also have a beneficial effect upon the economy.

In Spain the performance in the euro area is seen as a determinant factor for progress, while the Netherlands also emphasises the importance of the performance of the European economies.

The interdependence of the European economies is evident also from concerns expressed for France, where the performance of the German economy is cited as a specific factor in French economic performance, in addition to consumer confidence. In France the introduction of the 35-hour week continues to affect businesses, as do other regulations.

In Italy the difficulties currently being experienced in Latin America and South-East Asia remain aspects of concern. On the positive side there is the apparently sound budgetary implementation and an easing of monetary policy.

In Portugal and Luxembourg there is concern about the rate of inflation increasing from current levels (and the consequent increase in wage demands).

In Greece there is concern that fiscal policy might be loosened excessively, while the preparations for the Olympics, to be hosted in Athens in 2004, could make a positive contribution.

In Austria the lowering of taxes, and the easing of fiscal restraint should provide some positive impetus.

Finland notes the concern about disruption caused around Europe by the introduction of euro notes and coins. If successful, however, this is expected to increase consumer confidence after January 2002. Nevertheless, continued slowdown in IT investments remains a downside risk. The economy would be boosted by an revival in demand for electronics goods.

In the UK, further appreciation of sterling would pose downside risks. The main potential growth sources are a pick-up in consumer demand and business investment.

List of UNICE member federations surveyed in the Economic Outlook:

BDI	Germany
MEDEF	France
CONFINDUSTRIA	Italy
CEOE	Spain
VNO-NCW	Netherlands
IBEC	Ireland
CIP/AIP	Portugal
VOI	Austria
FEDIL	Luxembourg
TT/PT	Finland
VBO-FEB	Belgium
CBI	UK
DI	Denmark
FGI	Greece
SVENSKT NARINGSLIV	Sweden

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	B	D	EL	E	F	IRL	I	L	NL	A	P	FIN	EU-12	DK	S	UK	EU-15
Forecasts 2001																	
Real GDP (annual % growth)	1,8	1,2	4,2	2,7	1,9	6,5	2,0	3,9	1,7	1,4	2,3	0,8	1,9	1,2	1,4	2,0	1,9
Inflation (%)	2,4	2,5	3,7	3,7	1,7	4,0	2,8	3,0	4,8	2,5	4,3	2,5	2,8	2,3	2,8	1,2	2,5
Unemployment (%)	6,9	7,4	11,0	13,2	8,7	3,6	9,9	2,5	3,3	3,8	4,6	9,1	8,4	4,7	4,0	5,1	7,7
Nom. compensn of employees (annual % growth)													3,2				3,5
Forecasts 2002																	
Real GDP (annual % growth)	2,0	2,0	4,2	3,0	1,7	5,0	2,5	5,3	2,2	2,2	2,3	2,0	2,3	1,9	1,5	2,5	2,3
Inflation (%)	1,8	1,7	3,5	2,9	0,0	3,5	1,7	3,0	2,5	1,8	2,8	2,0	1,7	1,7	2,0	1,4	1,6
Unemployment (%)	7,1	7,1	10,7	12,5	9,1	3,7	9,4	2,5	3,8	3,7	5,1	9,3	8,3	4,6	4,1	5,1	7,6
Nom. compensn of employees (annual % growth)													2,9				3,2
Question 1	**Trend in business climate over the next 6 months**												Ind/Ser				Ind/Ser
positively										Ser		Ser	0 5	Ind Ser			2 5
negatively	Ind Ser	Ind Ser		Ind Ser	Ind Ser	Ind Ser		Ind Ser	Ind Ser		Ind Ser	Ind	76 74		Ind Ser	Ind Ser	79 77
neither pos not neg			Ind Ser				Ind Ser			Ind			24 21				20 17
Question 2	**Trend in profitability over the next 6 months**												Ind/Ser				Ind/Ser
positive													0 0	Ind Ser		Ser	2 18
negative	Ind Ser	Ind Ser	Ind		Ind Ser	Ind Ser		Ind Ser	Ind Ser	Ind Ser	Ind Ser	Ind	70 66		Ind Ser	Ind	74 55
unchanged			Ser	Ind Ser			Ind Ser					Ser	30 34				24 27
Question 3	**Trend in investment over the next 6 months**												Ind/Ser				Ind/Ser
positive							Ind	Ind		Ser		Ser	19 5			Ser	15 20
negative	Ind Ser	Ind Ser		Ind	Ind Ser	Ind Ser			Ind Ser	Ind	Ind		77 60	Ind Ser	Ind	Ind	81 50
unchanged			Ind Ser	Ser			Ser	Ser			Ser	Ind	4 35		Ser		3 30
Question 4	**Level of exchange rate with**												H/A/L				H/A/L
USD	Appr	Low	Appr	Low	Appr	Low	Low	Appr	Appr	High	Low	Low	3/32/65	Appr	Low	Appr	2/44/54
GBP	Low	Low	Appr	Low	na	Low	Low	Appr	Low	High	Low	Appr	3/4/73	Appr	Low	na	2/5/61
JPY	Low	Low	Appr	Low	na	Low	Low	Appr	Appr	Appr	Appr	Appr		Appr	Appr	Appr	
Euro	na	na	na	na	na	na	na	na	na	na	na	na		Appr	Low	High	
others: SEK	na	na	High	na	na	na	na	na	na	na	na	High		na	na	na	
Question 5	**Stance of monetary policy**																
tight							yes			yes			22			yes	34
appropriate	yes	yes	yes		yes	yes			yes			yes	64	yes	yes		55
loose				yes				yes			yes		14				11
Question 6	**What is your opinion of the ECB (conduct of monetary policy favourable to business, transparency)**																
positive		yes	yes	yes			yes		yes		yes	yes	72	yes			59
negative				yes		yes				yes			15				12
no answers	yes				yes			yes					24		yes	yes	38
Question 7	**Compared to 6 months ago, SME's cost/access to capital for business development is**												C A				C A
higher / more difficult									A	A	C A		3 11		A		2 12
same	C A	A			C A	C A	C A	A	C	C		A	53 75	A	C	C A	61 78
lower / less difficult		C	C A	C A				C				C	44 13	C			37 10
Question 8	**Trend in government bonds yields and stock market prices over the next 6 months**												U/S/D				U/S/D
Govt bond yields	down	down	up	up	down	down	same	same	down	up	same	down	19/59/22	up	same	down	15/64/21
Stock mkt prices	down	same	down	down	same	same	up	same	same	down	same	down	16/22/62	down	down	same	15/20/65
Question 9	**Trend of total tax burden on business in the past 6 months**																
increased						yes							1				1
decreased		yes			yes		yes						68				54
unchanged	yes		yes	yes				yes	yes	yes	yes	yes	30	yes	yes	yes	44

	B	D	EL	E	F	IRL	I	L	NL	A	P	FIN	EU-12	DK	S	UK	EU-15
Question 10	**Trend in total tax burden on business in the next 6 months**																
increase													0	yes			2
decrease			yes			yes	yes	yes	yes		yes	yes	33				27
no change	yes	yes		yes	yes					yes			67		yes	yes	72
Question 11	**What is your assessment of the budgetary policy programme for 2001?**																
positive			yes				yes	yes		yes		yes	26				21
negative		yes			yes	yes			yes		yes		59	yes			49
no answer	yes			yes									15		yes	yes	30
Question 12	**Implementation of the Stability & Growth Pact: what is your assessment of your country's multinannual stability programme?**																
positive	yes	yes	yes				yes	yes	yes	yes		yes	65		yes	yes	71
negative					yes						yes		22	yes			20
no answer				yes		yes							12				10
Question 13	**Do you expect new regulatory measures which would hinder business competitiveness?**																
Increase		yes			yes	yes			yes		yes		59	yes		yes	65
No change	yes			yes			yes	yes		yes		yes	39		yes		33
Decrease			yes										2				2
Question 14	**Overall trend in employment**												U/S/D				U/S/D
Ind: past 6 mnths	Same	Same	Same	Up	Down	Up	Down	Up	Same	Down	Down	Up	14/41/45	Down	Same	Down	12/35/53
Ind: next 6 mnths	Down	Down	Same	Up	Down	Down	Same	Same	Down	Down	Down	Down	11/22/67	Down	Down	Down	9/17/74
Ser: past 6 mnths	Same	Up	Up	Up	Down	Up	Up	Up	Up	Up	Up	Up	76/4/20	Same	Up	Up	79/5/16
Ser: next 6 mnths	Down	Down	Up	Up	Down	Down	Up	Up	Up	Down	Same	Up	40/3/57	Down	Same	Same	32/21/47
Question 15	**Expectation of labour markets over the next 6 months**																
more tight			yes										2				2
unchanged				yes			yes	yes		yes	yes		36	yes			30
less tight	yes	yes			yes	yes			yes			yes	62		yes	yes	68
Question 16	**Evaluation of labour productivity**												Ind/Ser				Ind/Ser
high	Ind					Ind	Ind	Ser					24 0				19 0
average	Ser		Ser			Ser	Ser	Ind	Ind	Ind Ser		Ser	12 61	Ind Ser	Ind	Ind	28 48
low		Ind Ser	Ind	Ind Ser	Ind Ser				Ser		Ind Ser	Ind	64 39		Ser	Ser	53 51
Question 17	**Compared with inflation and productivity growth, level of average wage increases:**												Ind/Ser				Ind/Ser
higher	Ind Ser			Ind Ser	Ind Ser		Ser	Ind Ser	Ind Ser				41 60	Ind Ser			34 49
same			Ind Ser			Ind Ser	Ind			Ind Ser		Ind Ser	28 9		Ind Ser	Ser	24 25
lower		Ind Ser									Ind Ser		32 32			Ind	41 25
One-off questions																	
A	**Will public finances achieve balance (or a surplus) over the medium-run/the economic cycle?**																
Yes	yes		yes	yes		yes	yes	yes	yes	yes	yes	yes	51	yes			42
No		yes			yes								49				39
no answer													0		yes	yes	19
B	**State pension system risks undermining the stability of public finances in the long-run?**																
Yes	yes	yes	yes	yes	yes		yes	yes		yes			88		yes		73
No						yes			yes			yes	9	yes		yes	25
no answer											yes		3				2
C	**Have reforms been introduced to improve the situation?**																
Yes	yes	yes					yes		yes	yes			61		yes		51
No			yes		yes			yes				yes	24	yes			21
no answer				yes							yes		13			yes	27
D	**Are public finances planned in the spirit of producing sound/consolidated budgets?**																
Yes		yes	yes	yes		yes	yes	yes	yes	yes		yes	74		yes	yes	77
No					yes								20				16
no answer	yes										yes		6	yes			7