THE VOICE OF BUSINESS IN EUROPE

BRUSSELS ECONOMIC FORUM

Panel on The Economic Outlook and the Broad Economic Policy Guidelines

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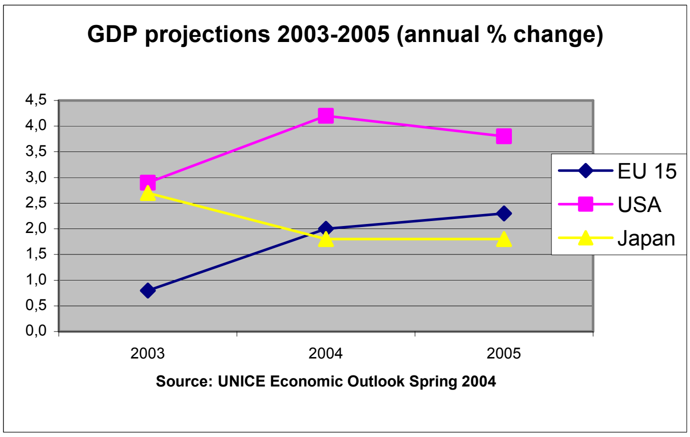
Speech by Philippe de Buck, Secretary General

1. Economic situation

Growth forecasts

- The Commission Spring Forecasts for the EU are very closed to the ones published by UNICE through its Economic Outlook of March 2004. Both documents expect an average growth rate of 0.8 in 2003 and 2% in 2004 for the European Union. Recovery seems to be in the air.
- However, this improvement is very limited compared to our main competitors and remains highly vulnerable to the world economy recovery. Emergent countries such as China or India are increasingly competing with European business even in highly sophisticated goods and services. According to a study by Goldman Sachs, the size China's economy will have overtaken Germany's by 2007, Japan's by 2015, and soon afterwards the whole of the EU zone, if nothing changes.
- Be aware that we are not talking about a temporary phenomenon. We are in the midst of a structural decline of the European economy!
- It is no time to relax! Europe should be its own motor for economic growth, by tackling some internal obstacles that stand in the way of competitiveness.



- UNICE also welcomes the growth opportunity that represents enlargement. Real GDP growth accounts for 3.6% in 2003, compared to the 0.8%. However, the need for reforms to speed up the transitory nature of the acceding economies should equally be promoted.

Employment

- The first victim of the lack of competitiveness in Europe is employment. Despite the expectation from both UNICE and the Commission of a slight improvement, unemployment rates will remain very high in Europe, around 8% in the coming years. Unemployment rate is also worrisome in the new member states, with a rate of 14.3% in 2003.
- Women are the ones who suffer the most from this unemployment stagnation with an average rate of 8.7% in 2002. The picture is still more worrying seeing the evolution of employment rates by age. Older workers are still suffering from employment rate of about 40% lower than the remaining population.
- Tackling unemployment roots is also a source of concern for European employers. Following the Wim Kok report on which the Broad Economic Policy Guidelines are partly based, it seems clear that EU will miss the overall intermediate employment rate target of 67% in 2005. Employment rate of older workers is also a considerable way off the 2010 target of 50% and is the main obstacle standing in the way of achieving the 70% employment rate agreed in Lisbon. UNICE welcomes the different Commission documents that have stressed the necessity to increase employment rate and productivity.

- Identifying the problems and possible solutions is important, but now it is high time to translate it into action. The need for reforms is urgent, in order to foster entrepreneurship, research and innovation, investment in human capital, efficiency in product, services and capital markets, financial sustainability of social protection systems. Providing the right incentives both for employers and individuals to engage in lifelong learning is also essential, to increase productivity and employment in Europe.

Investment

- Like the Commission, UNICE also witnesses a positive investment trend. Commission expectations of annual rates of 2.9 in 2004 and 3.9 in 2005 confirm the positive trend identified as starting from March 2003 in the last UNICE Economic Outlook. However, figures remain disappointing compared to other major economies.

Total Investment (annual % change, in volume)				
Investment	2002	2003	2004	2005
Eurozone	-1	-1	2.4	3.6
EU-15	-0.4	-0.5	2.9	3.9
EU-25	-0.2	-0.4	3.1	4.1
USA	2.8	3.9	7.4	4.3
Japan	3.8	3.2	4.3	2.4
Source: European Commission (2004), Economic Forecasts Spring 2004				

- Investment figures are more glimmering for the new Member States, as the Economic Forecasts expect total investment growth to increase from 1.9% in 2003 to more than 5% in 2004 and 7% in 2005. Investment is a very important factor to finance structural changes and to foster convergence. But if these expectations are to be fully confirmed, the stability conditions for investors such as a wise management of public finance, the enforcement of financing supervisory arrangements, should be ensured.

Consumption

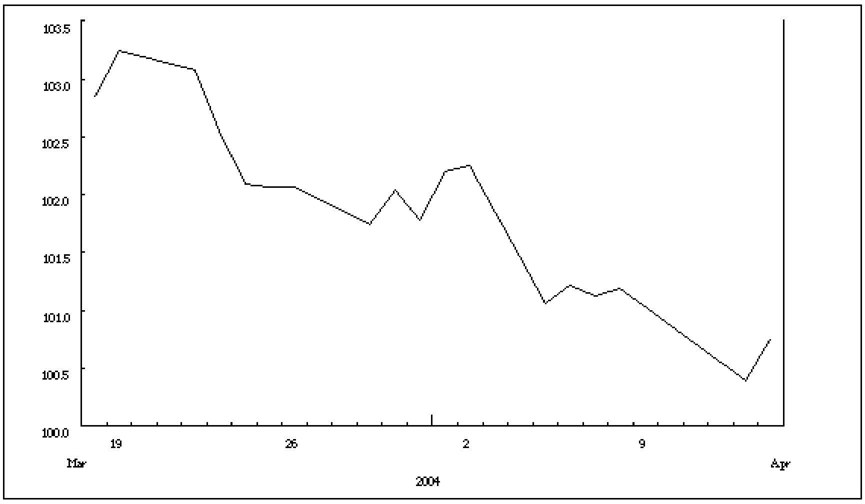
- Weakness of private consumption also reflects a worrying lack of consumer confidence. UNICE considers this factor as one of the explanations for the delay of the recovery. The terrorist threat is naturally not likely to improve the situation. Nevertheless, uncertainty towards structural reforms should be further underlined as an explanatory variable of this lack of confidence. Governments could substantially reduce this uncertainty, by better explain the benefits that citizens could get from reforms, such as Internal Market consolidation, networks industry liberalisation, fostering labour flexibility and long-life learning opportunities, ensuring financial sustainability of pension systems through pension reforms and budgetary consolidation, facilitating R&D investment, etc.

- Let's illustrate my talk by the case of Denmark. This country is upfront in labour market flexibility. A 2003 World Bank survey estimates an index for labour market regulation of 25 for Denmark, in contrast with the EU average of 51 with the rigid Spain and Portugal with respectively an index of 70 and 79. Denmark is not especially known for being an unsocial society. Labour market flexibility and a good social welfare system are not irreconcilable. On the contrary!It is, for example, fairly easy in Denmark to dismiss employees. This does make it less risky for entrepreneurs to hire in the first place.

Exchange rate

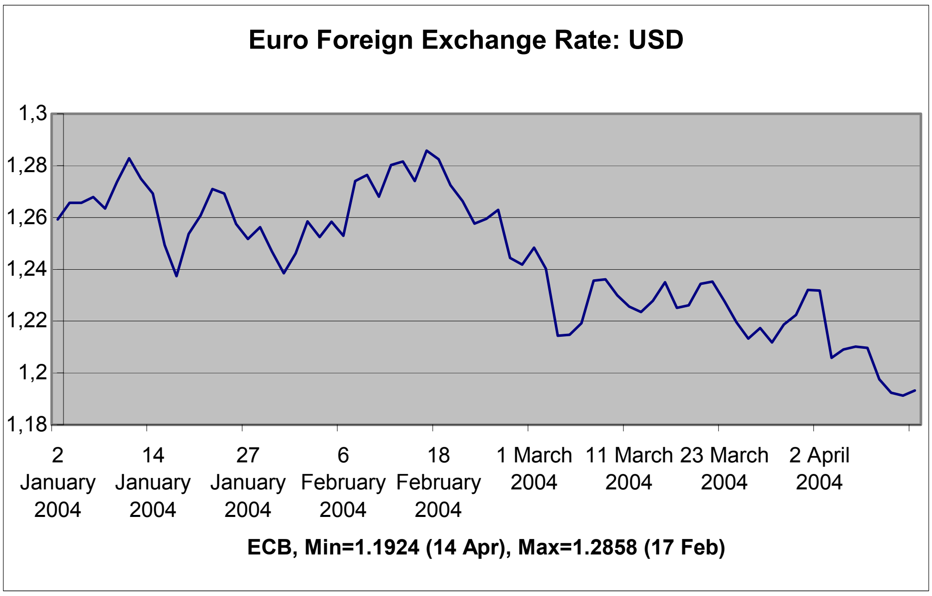
- Euro appreciation and its volatility is a very hot debate. But let's be clear: we are not so much interested in the discussion about the optimal level of the euro exchange rate. Actually, we are more worried about the detrimental impact of the currency fluctuations on European enterprises. Euro appreciation is shrinking the margins of European enterprises that export towards the dollar zone and subsequently, leads to labour costs and investment reduction. However, it has also some deflationist effects that should not be underestimated.
- UNICE considers the recent downturn trend observed in the effective exchange rate evolution since mid-March as a result of good monetary management (see graph). However, we should not take this release for granted due to the downward pressure of the American structural imbalances on the dollar level. Fluctuations rather than a determined exchange rate level is a main source of concern for European business, as this volatility makes more difficult any investment decision. Over the last 4 months, bilateral exchange rate with the US dollar has fluctuated between 1.18 and 1.29 %. From April 2003, between 1.07 and 1.29 %.

Nominal effective exchange rate over the last month (100=1999)

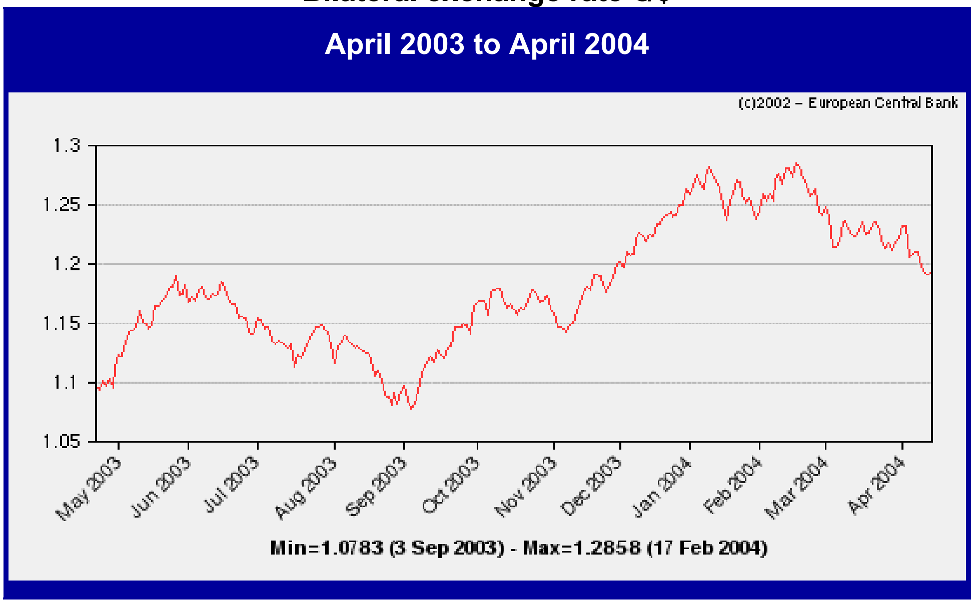


Source: ECB

Bilateral exchange rate €/$ (last data: 16.04.2004)



Bilateral exchange rate €/$



2. Macroeconomic policy

Let me now reflect on what could be done to improve competitiveness, growth prospects and employment creation through an effective economic policy. In short, the message could be summarized as follows: “Stick to the rules”, “keep an independent eye on price stability”, “don’t be too greedy” and “just do it”.

“Stick to the rules”, for the fiscal policy

- Budgetary deficits in France, Germany, Italy, the Netherlands, Portugal, and UK pointed by the Commission in its Economic Forecasts, are worrisome for the business community. This policy has serious negative consequences such as future tax increases, wrong signals to the financial markets, weakening of the ECB capacity to formulate an adequate monetary policy, etc.

- Respecting the Stability and Growth Pact is a necessary condition for a less vulnerable European economy to external shocks and for an effective monetary policy within the Eurozone. Let’s bear in mind the main reason for low growth in Europe. While the Pact is often unduly pointed as a “scapegoat”, lack of structural reforms remains the first point to blame.

- This is particularly true with a view on the EU enlargement. As stated in the Broad Economic Policy Guidelines, the average budget deficit in the ten new Member

States accounts for about 6% of GDP. This will require the necessary consolidation of public finances to underpin macroeconomic stability.

- This is simply the responsibility of national governments to make automatic stabilizers working properly, by consolidating budget in good times in order to smooth negative effects of economic recession.

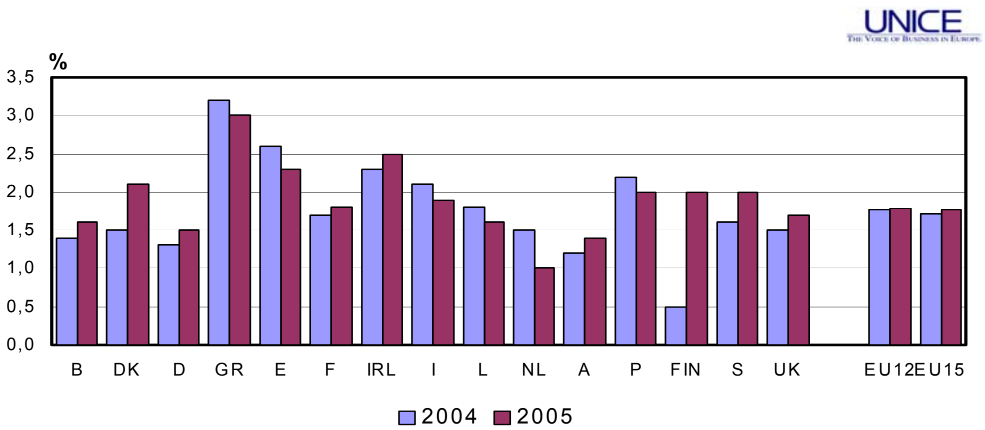
“Keep an independent eye on price stability”, for the monetary policy

- UNICE has no reason to complain on monetary policy and welcomes the improved communication strategy of the European Central Bank. Independence is essential, even if it does not mean going systematically against market expectations.

- If the euro's appreciation translates into lower inflation prospects, the ECB could have some room for manoeuvre. So far, the deflationist effect has been quite limited for several reasons: food prices affected by climatic conditions in summertime, import prices mainly captured by intermediaries, energy price increase and the importance of intra-European trade[1].

- Let’s also repeat that budget deficits in several Members States jeopardize the primary mission of the monetary authorities to stabilize prices. More supportive policy could not be provided, unless inflation convergence is improved. Europe is still characterised by substantial inflation differences, leading to a corresponding spread in real interest rates. Our Economic Outlook expect for the year 2004 inflation rates going from 0.5 in Finland to 3.2% in Greece in 2004, although the Commission underlines that these inflation differentials have slightly narrowed.

Forecast: Inflation rates 2003 and 2004 (Source: UNICE Economic Outlook Spring 2004)



[1] V. Riches-Flores (2004) « L’euro à 1,40 dollar: les consequences pour l’UEM », in *Problèmes Economiques* 2/248, pp. 4-10.

- Finally, exchange rate fluctuation is a real threat but constitutes the visible face of the iceberg. This turns me to the slow national implementation of structural reforms to improve competitiveness. Monetary policy could do nothing for that.

"Don't be too greedy", for the wage policy

- The Commission recognises that employment figures will not improve without stronger productivity gains. The Commission's Economic Forecasts estimate productivity gains at 0.6 in 2003 for the EU-15. As real labour cost is estimated to have increased by 1.5% in 2003 (EU-15, excluding Portugal), it seems rather clear that European companies suffered last year from a situation where real labour costs increased faster than productivity gains.
- The resulting lack of competitiveness is then not likely to reduce our high unemployment rate. UNICE joins the Commission's conclusion that progress towards the Lisbon objective "will depend crucially on the implementation of further labour reforms". UNICE will stress that wage moderation is necessary to help European enterprises to defend their market shares.
- At the verge of an historic enlargement, wage moderation should also be encouraged in these new Member States, particularly regarding the low productivity per worker in these countries. While Europe is already suffering from such a productivity weakness, productivity figures are almost half of the ones of current Member States. Labour reactivity could also be improved by allowing wages to better reflect productivity differences on local labour markets.
- The issue of lowering non-wage labour costs needs also to be addressed to give the European firms the opportunity to create more profitable jobs. This concerns the whole liberalisation process of public utilities, telecommunication, energy, or transport, etc.

"Just do it", for structural reforms

- Beyond cyclical budget and monetary measures, it is important that governments overcome their inertia in implementing structural reforms in the labour, financial and product markets.
- Many reports from EU institutions have emphasised the rigidities of the European economy. It is now urgent to transform declared intentions into concrete actions. Most recently, with the help of our Members, we have drafted a « Competitiveness Action

Plan », in which business federations address recommendations for reform policy directly to their national governments. These proposals cover several areas such as for example:

- Concerning the labour market, improving flexibility and mobility, promoting appropriate education and training systems, and ensuring the financial sustainability of pension systems through pension reforms and budgetary consolidation, are key channels of action.

- To foster entrepreneurship, private sector involvement in Research and Development activities should be eased. Company tax burden remains a huge obstacle to this involvement. Better regulation has also an important impact on the risk entrepreneurs are able to take to enter into a new business. It is worth to note that it takes on average only 4 days to start a business in the US while you need more than 40 days to so in the EU.

- Finally, UNICE has always stressed the potential benefits from completing internal market reforms. Here again, governments should face their responsibilities! The lack of implementation of internal market directives by several Member States is indeed unacceptable for the European business.

3. Conclusion

Before leaving you the floor, Mr. Chairman, I would like to say that UNICE broadly agrees with the general trends identified by the Commission in the Economic Forecasts and the Broad Economic Policy Guidelines. We also welcome the new focus given to new Member States in these documents. However, the Commission should better stress the urgency of structural reforms in this enlarged Europe, if competitiveness objective is to be achieved by 2010. These reforms should lead to greater productivity, growth rate and job creation. At the verge of an historic enlargement, the urgency of reforms will be increasingly evident, for some of our next challenges:

- How to fill the information gap between the European citizens and the European institutions? We believe that governments should better explain the necessity of the

Lisbon reforms to their citizens. The challenges of globalisation, technological change and population ageing are not being met with the necessary rigour. The message is clear: Europe is in danger of losing its attractiveness as a place for doing business.

- How to mainstream competitiveness priority? UNICE has supported the proposition to appoint a Vice-President of the Commission for Competitiveness (or Economic Reform) in the new Commission. This new post could indeed help to translate declared political goodwill into pro-competitive concrete action, by assessing the impact of all EU policy on this priority.

- How to finance the Lisbon objectives? UNICE draws particular attention to the debate on financial perspectives. If the Lisbon Strategy is to be fully implemented, we should give us the means of our ambition. At the verge of this inter-institutional dialogue, EU budget should act as leverage to the Lisbon goals of economic reform.

Europe is increasingly endorsing promising instruments of economic governance, such as the Broad Economic Policy Guidelines and Employment Guidelines. UNICE believes that it is now high time to make them work properly, to endorse our responsibilities to meet the new challenges of the twenty-first century and to achieve valuable results in the field of competitiveness.

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