29 April 2004

EUROPE IN STRUCTURAL DECLINE: URGENT MEASURES TO BE TAKEN

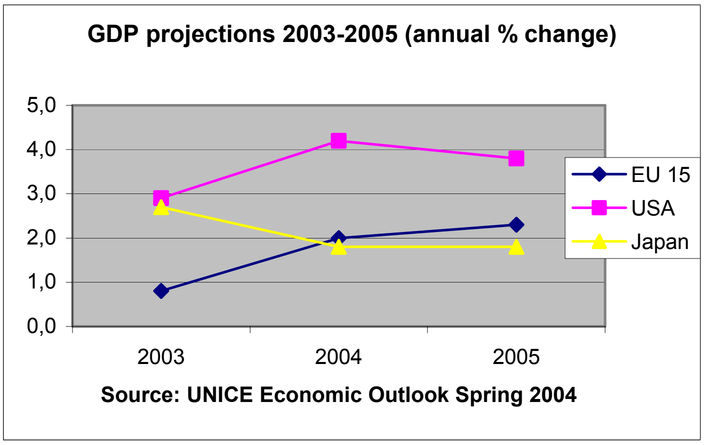
UNICE statement
to the macroeconomic dialogue at technical level on 29 April 2004

1. ECONOMIC SITUATION

Growth forecasts: a delayed, modest and vulnerable improvement

- The Commission Spring Forecasts for the EU are very close to the ones published by UNICE in its Economic Outlook of March 2004. Both documents expect an average growth rate of 0.8% in 2003 and 2% in 2004 for the EU. In 2005, UNICE and the Commission expect growth rates for the EU to increase at around 2.3%. Recovery seems to be in the air.

- However, this improvement is very limited, compared with our main competitors and remains highly vulnerable to the world economy recovery. Europe should be its own motor for economic growth, by tackling some internal obstacles that stand in the way of competitiveness. More worrying, some of our Members are starting to correct downward their previous growth forecasts.



- UNICE also welcomes the growth prospects that enlargement offers. Real GDP growth accounts for 3.6% in the new Member States in 2003, compared to the 0.8% in the current Member States. However, the need for reforms to speed up the transition of the acceding economies should be strongly promoted.

- The risk of relocation on the EU-15 growth prospects is also a source of concern. Investment of enterprises who are looking for productive investment could affect not only low-skilled but also highly sophisticated activities. However, the fear of relocation should not be overestimated. Reallocation of resources is a natural adjustment process towards global efficiency. Actually, this is more worrying when it reflects a weakening competitive advantage in Europe, resulting from the slow pace of reform implementation in increasingly competitive global markets.

- We must be aware that we are not talking about a temporary phenomenon. We are in the midst of a structural decline of the European economy. This is an urgent time to take measures.

- We are living in an age of a global economic revolution. The growth rates in China and India defy comparison with anything in Europe. And it would be wrong and arrogant to dismiss this as non-comparable to the developed G7 countries. 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.

Employment: structural unemployment still very high

- Despite the expectation from both UNICE and the Commission of a slight improvement, unemployment rates will remain very high in Europe ranging from 8.0% to 7.9% between 2003 and 2005 for EU-15 with unchanged policy. Unemployment is also worrisome in the new Member States, with an average rate of 14.3% in 2003.

- The Commission recognises that employment figures will not improve without stronger productivity gains. Following the Labour Cost Monitor traditionally sent by the Commission a few days before the Macroeconomic Dialogue, 2003 is the third successive year of fairly sustained rises in unit labour costs. Wage moderation remains more relevant than ever. Otherwise, European companies might suffer from a situation where real labour costs will increase faster than productivity gains. The resulting lack of competitiveness is then not likely to reduce our high unemployment rate.

Investment: still modest and disappointing vis-à-vis the US

- Like the Commission, UNICE also sees 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 with other major economies.

- Investment figures are clearly higher 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 support structural changes and to foster convergence. But if these expectations are to be fully confirmed, stability conditions for investors such as wise management of public finance, enforcement of financial supervision arrangements must be ensured.

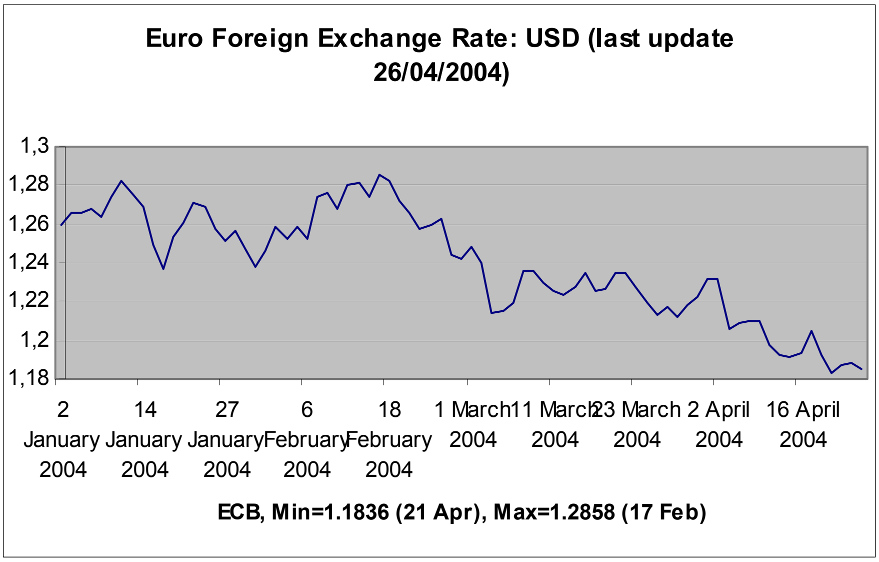
Consumption: very limited expansion

- Weakness of private consumption also reflects a worrying lack of consumer confidence. UNICE considers this factor one of the explanations for the postponement of recovery. The terrorist threat is clearly not likely to improve the situation. Nevertheless, uncertainty about structural reforms should be further underlined as an explanatory variable of this lack of confidence.

- Governments could substantially reduce this uncertainty, by better explaining the benefits that citizens could reap from reforms, such as Internal Market consolidation, network 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.

Exchange rates: must reflect fundamentals

- Euro appreciation and its volatility are certainly harming European enterprises doing business in international markets. Furthermore, euro appreciation is shrinking their margins and subsequently, leads to lower labour costs and investment. UNICE welcomes the recent downturn trend observed in the effective exchange rate since mid-March. In addition to this static view, fluctuations make more difficult any investment decision. Over the last four months, the bilateral exchange rate against the US dollar has fluctuated between 1.18 and 1.29. Over the last twelve months, the lowest point was about 1.07 while the highest point reached the value of 1.29.



2. MACROECONOMIC POLICY

Fiscal Policy: sound fiscal policy and true recovery go hand in hand

- Budgetary deficits in several countries pointed out by the Commission in its Economic Forecasts, are worrisome for the business community. This has serious negative consequences such as future tax increases, wrong signals to financial markets, weakening of ECB's capacity to formulate an appropriate monetary policy, etc.

- Sound fiscal policy also means good quality and cost efficiency in expenditures. Even in times of restricted fiscal policy, investment in infrastructure must be maintained. Expenditure decision should be made, with a view on strengthening its competitive advantage. As stated in the Commission Communication ""Public Finances in EMU-2003" of 21 May 2003, budget consolidation should also avoid being translated into tax increases but should take the form of expenditure retrenchment. Furthermore, budget consolidation could have a positive impact, even in the short run, when it is combined with structural reforms on factor and product markets.

- Respecting the Stability and Growth Pact is a necessary condition for an effective monetary policy within the Eurozone. We should also bear in mind the main reason for low growth in Europe. While the Pact is often wrongly identified as a "scapegoat", lack of structural reforms remains the first point for blame.

- This is particularly true with a view to 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. UNICE welcomes the growth opportunity that enlargement represents. However, fiscal discipline, inflation control and, above all, structural reforms should be further promoted in new Member States.

- It is the responsibility of national governments to make automatic stabilisers work properly, by consolidating budgets in good times in order to smooth the negative effects of economic recession.

Monetary Policy: the advantage of low and stable prices must be maintained

- UNICE has no reason to complain about monetary policy and welcomes the improved communication strategy of the ECB.

- As stated in the UNICE Economic Outlook, if the euro's appreciation translates into lower inflation prospects, the ECB could have some room for manoeuvre. So far, the deflation effect has been quite limited for several reasons: higher food prices caused by hot summer, import price savings mainly creamed off by intermediaries, higher energy prices and the importance of intra-European trade. And, as the ECB President J.-C. Trichet has just stated at the G7 meeting in Washington (24 April) "all options are still open".

- Energy prices increases are still threatening both global and European recovery and inflation control. Raw material prices - and more and more its availability on the market- have also shown some worrying upward pressure. Furthermore, budget deficits in several Member States are jeopardizing the primary mission of the monetary authorities, which is to stabilise prices.

- We are naturally interested in a low level of interest rates over a long period of time, provided that inflation is kept under control. Exchange rate fluctuation is seen as a real threat but should not hide the main reason for poor economic performance. Structural reforms should be further translated into Member States' legislation to improve competitiveness. Monetary policy can do nothing in that regard.

Labour costs: wage moderation fosters employment

- UNICE shares the Commission's conclusion that progress towards the Lisbon objective "will depend crucially on the implementation of further labour reforms". UNICE also stresses that wage moderation is necessary to help European enterprises to defend their market shares.

- Labour costs should also be monitored in the new Member States, particularly regarding the low productivity per worker in these countries. While Europe is already suffering from productivity weakness, productivity in the Member States is almost half of that of current Member States. Labour reactivity could also be improved by allowing wages to better reflect productivity differences on local labour markets.

- Non-wage labour costs should also be reduced to give the European firms the opportunity to create more profitable jobs. This is particularly worrying, bearing in mind the last Labor Cost Monitor, which stresses that "policy-dependent increases in non-wage labour costs still partially offset the effect of moderate wage growth".

Structural Reforms: the longer we wait, the more difficult it is, for diminishing returns! So, just do it!

- Beyond cyclical budget and monetary measures, it is important that governments overcome their inertia in implementing structural reforms in labour, financial and product markets.

- Many reports from EU institutions have emphasised the rigidities of the European economy. 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 reforms covers several areas including:

  - 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 facilitated. Company tax burden remains a huge obstacle to this involvement. R&D activities are promoted not only by spending the 3% of GDP required by the Lisbon Strategy but also by creating the right environment for entrepreneurship and innovation.

  - Better regulation has an important impact on the risk entrepreneurs are able to take when entering into a new business. Many regulations are unnecessary and too complex. The political will to refine the integrated impact assessment process expressed at the last European Council of 25/26 March should be translated into red tape reduction at the national level. We must free European enterprises from this excessive regulation.

  - Finally, UNICE has always stressed the potential benefits of completing internal market reforms. This is particularly true for services, which have an increasing weight in the European economy. The lack of implementation of internal market directives by several Member States is unacceptable for European business.

3. CONCLUSION: RECOVERY IS NOT GIVEN, TO UNDERSTAND THE INTERTWINING BETWEEN SHORT- AND LONG-TERM DEVELOPMENTS IS KEY TO BOLSTER THE CURRENT IMPROVEMENT AND TURN IT INTO A TRUE RECOVERY

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 placed on new Member States in these documents. However, the Commission should better stress the urgency of structural reforms, if the competitiveness objective is to be achieved by 2010. These reforms should lead to greater productivity, foster growth and job creation.

New proposals should contribute to mainstreaming competitiveness in all EU policies.

- Implementing the Lisbon Strategy is not an option, but an urgent necessity. We are far behind our main competitors. Europe is losing ground in increasingly global competition. The lack of structural reforms is primarily to blame!
- The implementation of the right policies to achieve the Lisbon Goals must be the priority of the next institutions: the European Parliament and Commission. In order to have a more horizontal view, we support the proposal made by different European

leaders to appoint a Vice-President of the Commission for Competitiveness. This new job could help to translate declared political goodwill into pro-competitive concrete action, by assessing the impact of all EU policy on this priority.

- It is high time to understand the challenges that business is facing every day. Release companies'potential! Excessive regulatory burden is hindering growth and job creation. Necessary fiscal consolidation should avoid being translated into tax increases but should take the form of expenditure retrenchment and reallocation.

- The current debate on the financial perspectives is also an opportunity to emphasis competitiveness in EU policy. If the Lisbon Strategy is to be fully implemented, we should give ourselves the means to achieve our policy priority. On the eve of this inter-institutional dialogue, the EU budget should act as a lever for the Lisbon goals of economic reform. Give us the financial means at the EU level to encourage a new breed of industry.

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