FOUR CONDITIONS FOR RECOVERY

'The EU now has a unique opportunity to set the course for a coherent growth strategy'

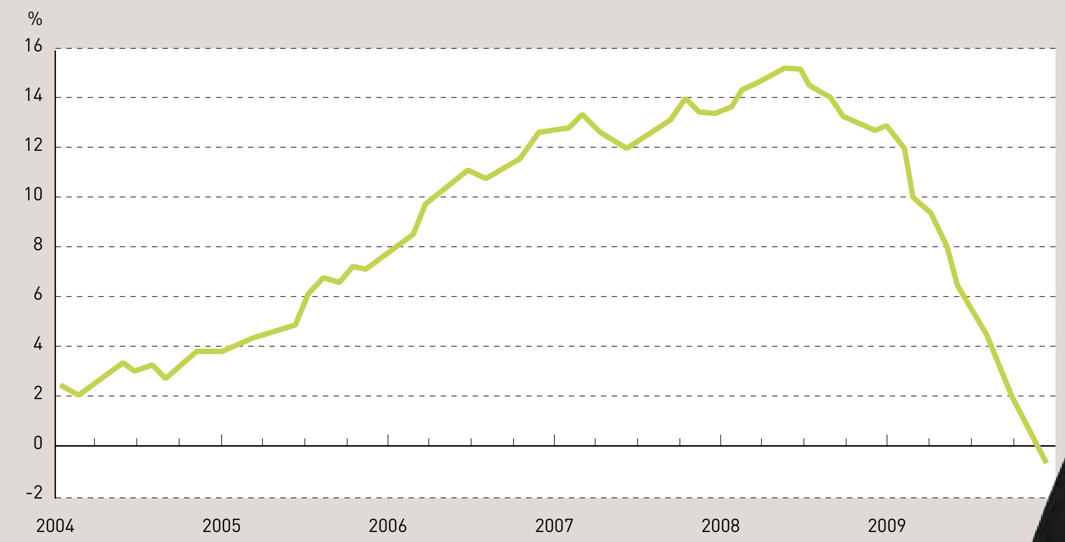
1. STABILISE FINANCIAL MARKETS

Shortcomings in the world financial system must be fixed to avoid a repetition of pre-crisis excesses. Financial innovation is as important as technical innovation to foster economic growth. It must therefore be preserved. However, to secure responsible growth, the quality of financial products needs to be verified. Deficiencies in quality control were an important factor in the crisis. They need to be addressed through appropriate and proportionate regulation. Financial markets should be regulated in a smart way, so that productive investment and entrepreneurship are not stifled but encouraged.

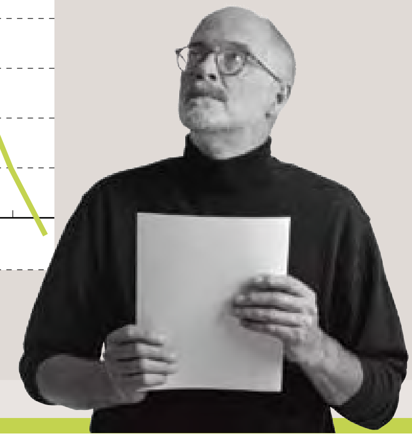
Financial supervision needs to be improved to identify the emergence of systemic risk in good times. But effective cross-border supervision also requires further thinking on burden-sharing and bank resolution systems in the European and global context, as well as on the need to secure affordable access to financing for companies.

There is a real the risk of over-regulation of the financial sector in the aftermath of the crisis. Policy-makers are discussing a multitude of new capital requirements to be imposed on financial institutions. All proposals have their individual merits but their combined effect on the availability of credit, especially for SMEs, has not been properly assessed. Capital ratios, if they are not well conceived, could substantially harm growth prospects on our continent.

Chart 6 Euro-area bank loans



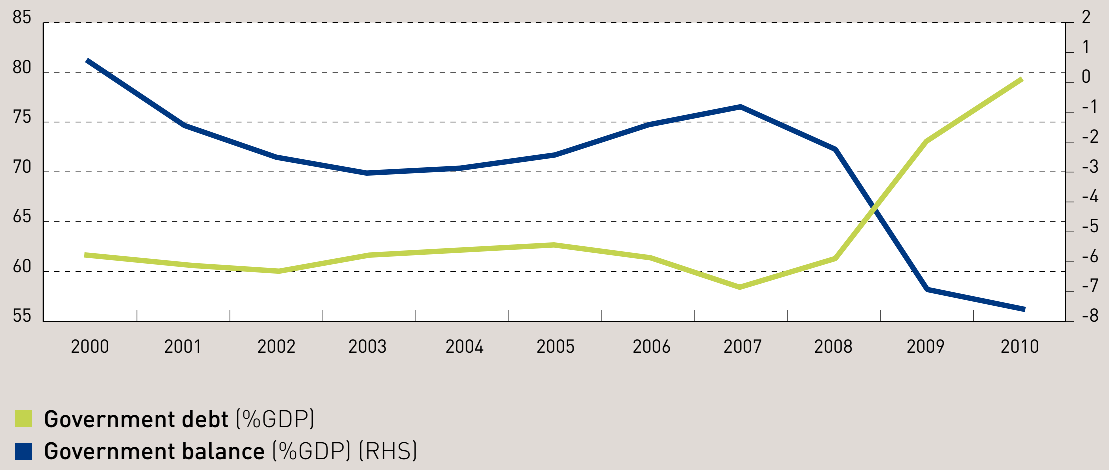
Source: ECB



2. RETURN TO SOUND PUBLIC FINANCES

After the economic crisis of the 1970s, many European countries experienced the dampening effects of excessive public deficits on growth and employment. The current fragile recovery cannot be transformed into sustained growth if excessive debt is simply shifted from the private to the public sector.

Chart 7 Government debt and budgetary balance



Source: DG ECFIN (AMECO Database)

Restoring confidence in public finances requires clear commitments on when and how to consolidate public finances. If the recovery lasts, the consolidation should start no later than 2011. But the nature of consolidation measures is equally important. Higher taxation, particularly on labour and capital, will damage growth and job prospects. The priority must be to reduce public spending and rebuild the tax base through growth-enhancing reforms.

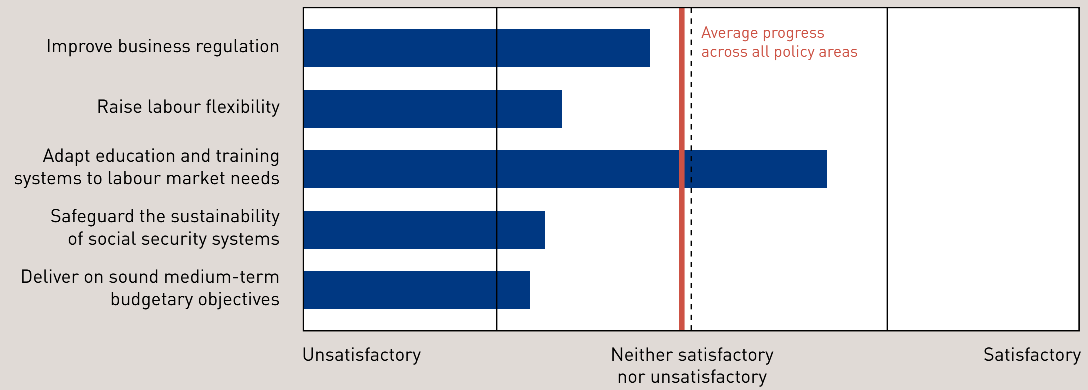
The Stability and Growth Pact remains the appropriate framework to coordinate a return to sound public finances. Greater focus on debt sustainability and structural reforms will be key to combine growth and fiscal consolidation in the years ahead.

In order to become a vehicle for economic growth, the EU budget should be reshaped. Today, 40 % is spent on the common agricultural policy and rural development compared with 8 % only on competitiveness-related projects. The strategic choices of the EU to improve competitiveness must be better reflected in its budget.

3. SPEED UP STRUCTURAL REFORMS

Structural reforms are a precondition for a lasting return to growth, enhanced job creation and healthier public finances. The economic downturn slowed down the progress of reform. Only reforms to adapt education and training systems moved forward. Governments are not sufficiently tackling those areas that entail more difficult reforms such as improving business regulation, increasing labour market flexibility, safeguarding the financial sustainability of social security systems and delivering sound medium-term budgetary objectives.

Chart 8 Recent reform progress in key priority areas for 2009



For the complete Reform Barometer, go to www.businesseurope.eu.

Source: BUSINESSEUROPE Reform Barometer Survey

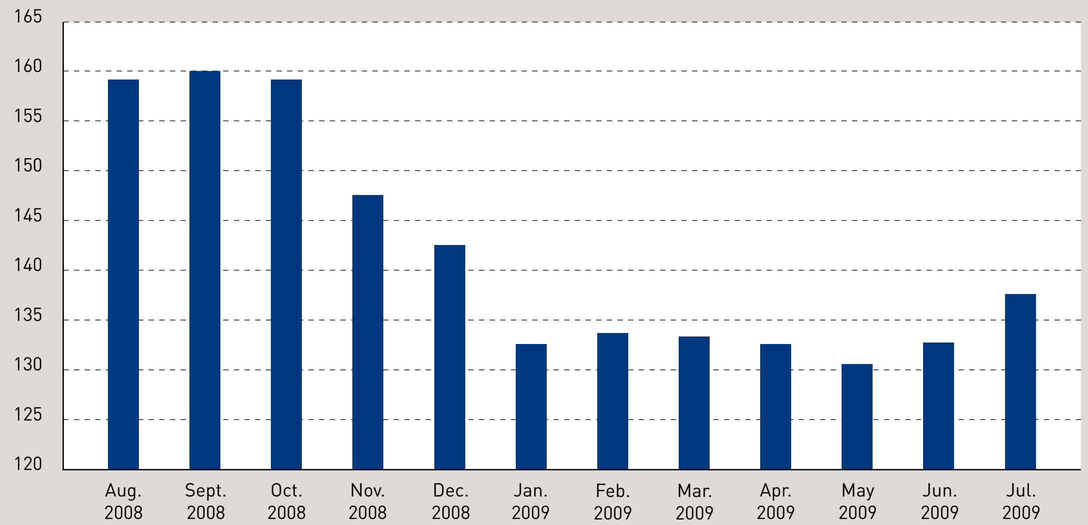
We expect structural reforms to be speeded up. The Commission should be vigilant in its monitoring and evaluation of these reforms and help reinstate a true benchmarking and peer-review culture among Member States. The experience of some member states, such as Poland, shows that structural reforms can play as important a role as financial stimulus packages to soften the effects of the crisis.

Speeding up reforms is also necessary to increase the benefits of the Euro. Current and prospective members of the Euro zone will need to strengthen their collective responsibility and individual commitments to structural reforms, fiscal discipline, sustainable competitiveness and strong representation at the international level. Reinforced governance of the Euro area will help to foster deeper market integration in the wider EU and an enhanced role of the Euro as an anchor of global economic and financial stability.

4. KEEP MARKETS OPEN

The economic crisis has triggered a 9% decline in global trade in 2009 and created pressure for protectionist measures. Although the worst-case scenario of full blown protectionism has been avoided, more than 220 potentially trade-restrictive measures have been taken, affecting up to 5.2% of EU exports. Subsidies and restrictions in government procurement are areas of particular concern.

Chart 9 Decline in global trade



■ **Volume world trade** (2000 = 100)

Source: BUSINESSEUROPE and CPB Netherlands Bureau for Economic Policy Analysis

As the world's largest exporter, Europe has a lot to lose from protectionism. To keep markets open, the EU should continue to monitor protectionist measures, especially since high unemployment and budget deficits can increase pressure for trade restrictive measures. Europe should also convince its trading partners to abandon protectionist measures such as export taxes and "buy China" or "buy America" provisions. The EU should also take appropriate enforcement measures when there are violations of WTO or other international trade agreements.

Regulatory divergences can also undermine trade and investment. The EU should use its bilateral dialogues, in particular with the USA, to prevent damaging divergences in, for example, financial sector regulation. Last but not least, a successful conclusion of the Doha Round would restore confidence in open markets and accelerate world recovery.

KEY POLICY RECOMMENDATIONS

→ **PUT IN PLACE** SMART FINANCIAL REGULATION ON FINANCIAL SUPERVISION AND BANKS' CAPITAL REQUIREMENTS RULES TO AVOID UNNECESSARY NEGATIVE EFFECTS FOR GROWTH AND EMPLOYMENT.

→ **AGREE** ON AN EXIT STRATEGY FROM EXCESS PUBLIC DEBT AND DEFICITS IN THE CONTEXT OF THE GROWTH AND STABILITY PACT.

→ **MONITOR AND EVALUATE** STRUCTURAL REFORMS IN THE CONTEXT OF THE EUROPEAN GROWTH AND JOBS STRATEGY.

→ **RESHAPE** THE EU BUDGET TO INCREASE THE SHARE OF COMPETITIVENESS-RELATED EXPENDITURE SUCH AS RESEARCH AND INNOVATION, INFRASTRUCTURE OR EDUCATION.

→ **KEEP MARKETS OPEN** THROUGH BILATERAL DIALOGUES, TRADE NEGOTIATIONS AND ENFORCEMENT OF TRADE RULES.