BUSINESSEUROPE

SPEAKING NOTES

GO FOR GROWTH
AN AGENDA FOR THE EU IN 2010-2014

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Dear participants,

As there has been more than a fair share of bad news lately, please let me start on a positive note. We have been quite optimistic about the outlook for industry at the start of the year, and had predicted early February that real GDP growth in the EU would reach 1.2%, double what the commission had estimated at that time.

Our confidence has been vindicated. The latest industrial production data, which grew for the 9th consecutive month in February to reach an annual increase of 3.5% in the EU and 4.1% in the euro area, confirms a significant improvement driven by exports and a turnaround in the inventory cycle. The air traffic problems after the eruption of the Icelandic volcano will probably have a substantial knock on effect in the second quarter of the year, but we believe the recovery is still on track.

However, we also acknowledge that the recovery in Europe is more sluggish than in the rest of the world, not only vis-à-vis emerging markets but also the US and other developed economies. This is worrying because (1) companies with an international outreach are reviewing their strategies and might reassess investments in Europe in such a global environment and (2) without faster growth the necessary process of fiscal consolidation and a return to financial stability will be more difficult.

So we need to draw the right lessons from the crisis, with a triple objective in mind: (1) build up greater resilience in the financial sector, (2) restore fiscal sustainability and (3) accompany the necessary restructuring of industry and promote its competitiveness.

So what have we learned in industry over the last two years?

<u>Lesson 1: industrial activity is tightly interconnected with the functioning of capital markets</u>

Consider investment and trade, which are two engines of growth. They were simply put on hold when the credit crisis struck. Everybody was shocked at the speed and severity of the transmission between capital market failures and industrial activity at the end of 2008 and early 2009.

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So we in industry understand and greatly support the need for reforming financial markets in ways that reduce systemic risks and reinforce at same time their capacity to service the economy and restore access to finance.

The fundamental point here is to find the right balance between stronger prudential rules, better supervision and improved crisis resolution systems when they occur. We think this optimal balance has not been found yet.
Coherence in missing, particularly in the area of capital requirements where initiatives are just being stacked one on top of the other without having an overall assessment of their effects on the economy.
This is worrying, particularly for European industry which rely heavily on bank intermediation for its finance. Impact assessments should be much broader and comprehensive, analysing the cumulative effects of all relevant prudential rules affecting the banking sector but also the insurance sector and other actors. These rules are interacting in complex ways to influence decisions regarding companies finance.
Beyond stability-oriented reforms, new financing channels will need to be developed to support the modernisation our economy. In this regard, we need in Europe true markets for innovation and infrastructure financing. The functioning of venture capital markets, but also the role of the European Investment Bank can play a vital role.

Lesson 2: Fiscal sustainability is an immediate concern for industry

When we ask our members what is the first policy priority for national governments, they invariably mention fiscal sustainability. Why is the state of public finances so important for companies?

For two main reasons:

1. Rising public debt will inevitably raise the cost and reduce the availability of finance for companies and continue to pose a severe threat to financial stability;

2. Higher taxation for companies and an increasing interest burden for governments will dislocate productive resources and wipe out any chances of a sustained recovery;

The challenge ahead is formidable. We have calculated that a doubling of EU's growth potential, to at least 2%, and sustained primary surpluses (government budget balance excluding interest payment) of close to 3% of GDP will be needed to put public debt on a sustainable course (back to 60% of GDP by 2025).

A common exit strategy is slowly taking shape in Europe, which includes in the short run the introduction of an ad-hoc crisis management framework to deal with sovereign default risks in the euro area. This will obviously have consequences for its future governance, in terms of budgetary controls, tighter surveillance of economic policies and crisis resolution instruments.

But the parameters of a comprehensive strategy able to combine growth and fiscal sustainability are yet to be defined at EU level. This can only be achieved through a clear reassignment of priorities.

We have proposed a two pillar approach. On the one hand, an exit strategy should comprise credible commitments towards tighter fiscal rules and institutions, greater efficiency of public administrations, credible cost-cutting measures, greater recourse to markets and reforms of pension and healthcare systems.

This should be combined with an entry strategy based on renewed commitments to address the challenge of enhancing the competitiveness of education, research and innovation systems as well as of infrastructures in Europe.

Creating a conducive macroeconomic and budgetary framework to address this challenge is an important dimension of the new integrated industrial policy that needs to be developed in Europe, but not the only one.

That brings me to the third lesson of the crisis, which is:

<u>Lesson 3: We can no longer afford to remain at the level of grand conceptual debates when it comes to deploying this new integrated European industrial policy</u>

The earlier economic crises that Europe has been through accelerated the natural process of structural adjustment within various industrial sectors.

What we are seeing today is that entire industrial sectors are in trouble, and that the position of European industry as a whole is in retreat. Between 2000 and 2010, the share of emerging countries in worldwide industrial output increased from 32 to 52%. This highlights problems which go beyond the scope of good management initiatives by companies themselves.

The crisis has shown that the absence of determination in deployment of certain horizontal policies such as the internal market or the transition to better regulation is handicapping European industry in international competition. It has also shown that industrial competitiveness policy objectives are insufficiently incorporated right across the European agenda.

All this demonstrates again the need to move towards an integrated EU industrial policy comprising the following three elements:

-active development of the basic EU horizontal policies (favourable macroeconomic conditions, internal market, competition policy, better regulation,…);
-launch of EU sectoral initiatives aimed at stimulating demand and markets for innovative products and services, and improving the specific operating framework of certain sectors;
-integration and coordination of all policy areas which have an impact on industry: for example transport policy, environment policy, ICT policy, consumer policy, research

policy. This also encompasses how the EU spends its budget and how it promotes innovation and entrepreneurship. All these areas must be coordinated with each other.

The need of implementing this integrated industrial policy agenda has been recognised by the Council. Under the impulse of the Commission, many proposals for sectoral initiatives and reforms have been made by industry. It is now high time to move towards action, and BUSINESSEUROPE is fully ready to cooperate with Vice-President Tajani for designing and implementing such a broad action agenda.