

25 May 2010

BRUSSELS ECONOMIC FORUM

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ENSURING EUROPE'S ECONOMIC FUTURE: WAYS OF RAISING EUROPE'S GROWTH POTENTIAL, CREATING MORE JOBS AND BEING MORE INNOVATIVE

The challenge ahead

- Europe is living a moment of truth. Bold actions were decided to address risks of a sovereign debt crisis in the euro area getting out of control.
- This has demonstrated solidarity with most affected countries and a strong commitment to the euro. But the 9/10 of May agreement while welcome, is only buying some time.
- To guarantee the stability and long term success of the euro, far-reaching measures will have to be taken rapidly.
- The obvious challenge ahead is to combine fiscal discipline and growth, not only in the euro area but in the EU as a whole.
- We estimate that 2% growth and 3% surplus in government primary balance are the headline targets to restore fiscal sustainability in Europe. Mission impossible?
- We don't think so but it will require political courage and hard choices.
- First, we need to accept that the current instability is the result of years of indulgence and poor governance. The financial crisis and the sovereign debt crisis share important features in this regard:
 - easy money (as markets barely differentiated risks among countries),
 - excessive leverage and lack of prudence in good time,
 - poor accounting (Greece misreporting) and
 - Insufficient supervision (failure to enforce the Stability and Growth Pact effectively).
- As a consequence, several Eurozone countries have had to put in place drastic austerity measures to restore confidence in their long term future, including wage cuts and a reduction in social benefits.
- We recognise the magnitude of the sacrifices these measures imply for workers, pensioners and citizens. However, they are the only way to overcome this crisis and ensure the continuity of our social systems in the medium- and long-term. It is



therefore encouraging that in most parts of Europe, to quote yesterday's Financial Times, "voters seem to accept this bitter medicine".

- This needs to give way to a more positive agenda of growth-enhancing reforms.

Combining exit and entry strategies

- In our March report "Combining Fiscal Sustainability and Growth: a European Action Plan" we have recommended a comprehensive approach. This agenda is organised around the following broad orientations:
- An **exit strategy to cap public indebtedness**, including better fiscal rules and institutions, cost cutting measures, efficient public services and social security reforms.
- These measures must be complemented with the so called **entry strategy addressing those areas where the economic future of Europe lies**. It includes:
 - ambitious reforms of **education and training systems** to better match the supply and demand for skills
 - **More and better targeted efforts in R&D and innovation**: making sure that they lead to tangible results
 - **A reprioritisation of infrastructure investments**, promoting projects tightly linked to innovation and growth
 - **Finally, we need growth-enhancing tax reforms**. Tax structures need to be revisited and simplified. What we need to avoid is a consolidation process driven by higher taxation or new tax levies, which will end up having limited or even negative effects on fiscal sustainability in the long term.

Improving euro area governance

- But recent developments have also stressed the need to rethink the economic governance of the European Monetary Union. Over the last decade, fundamental reforms have been delayed, consolidation efforts in good times inexistent and the Stability and Growth Pact rules openly ignored.
- We had already alerted to these issues as well as to the long term consequences of growing macroeconomic imbalances in the euro area in our 2007 report "Fit with the euro".
- A reinforced governance structures for the euro area should mean in particular to
 - transpose the Stability and Growth Pact Rules into national law
 - Broadening the concept of fiscal sustainability
 - Reinforcing the surveillance of national economic policies
 - Imposing gradual penalties in case of repeated indiscipline
 - Working on a system to address sovereign debt crisis and last resort situations



- This will have to be included in the broader context of the EU2020 strategy. Europe has an incredible untapped potential for growth if each member state addresses its growth bottlenecks with forceful actions.
- All countries have weaknesses. It is the role of the Commission to help identify these weaknesses and promote a real benchmarking culture in Europe.

Conclusion

- Companies are very concerned about the current situation but also see it as an opportunity for change, both for their business and for EU's growth model more generally.
- We are convinced that if our leaders do not forget the lessons from the current crisis any time soon, they will agree on the necessary actions to tackle both immediate concerns and long term challenges facing the EU economy. There is no other choice left.

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