BUSINESSEUROPE

SPEAKING NOTES

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EUROPE'S 500 SUMMIT ON GROWTH FINANCING VERSUS DELEVERAGING: A CONTRADICTION?

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The focus of this conference is on how to solve the dilemma of stabilising public sector budgets, banks and currency while restoring growth at the same time. Against this background, I would like to comment on three points:

- First, I would like make some comments on the economic situation in Europe as emerges from BUSINESSEUROPE's most recent Economic Outlook;
- Then I will elaborate on the main strands of overall EU strategy that need to be implemented to bring us back to a path of sustained growth;
- And finally, I will comment on current difficulties on business access to finance and share with you BUSINESSEUROPE's recommendations to alleviate them.

<u>Recent economic developments</u>

The latest BUSINESSEUROPE economic situation review shows that the recovery in Europe is still consolidating despite the persistent uncertainty and instability in financial markets.

The EU continues to benefit from dynamic growth in the rest of the world, while domestic demand is gradually strengthening.

This is illustrated by the following chart which shows the vigorous and parallel recovery since the beginning of 2009 in world trade, in industrial production in Europe and in the European industrial confidence index.

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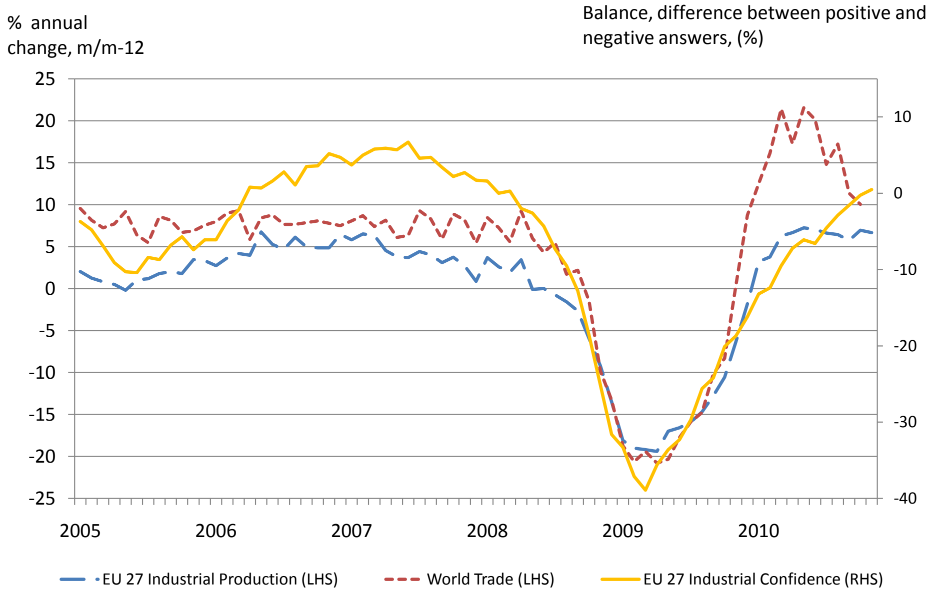
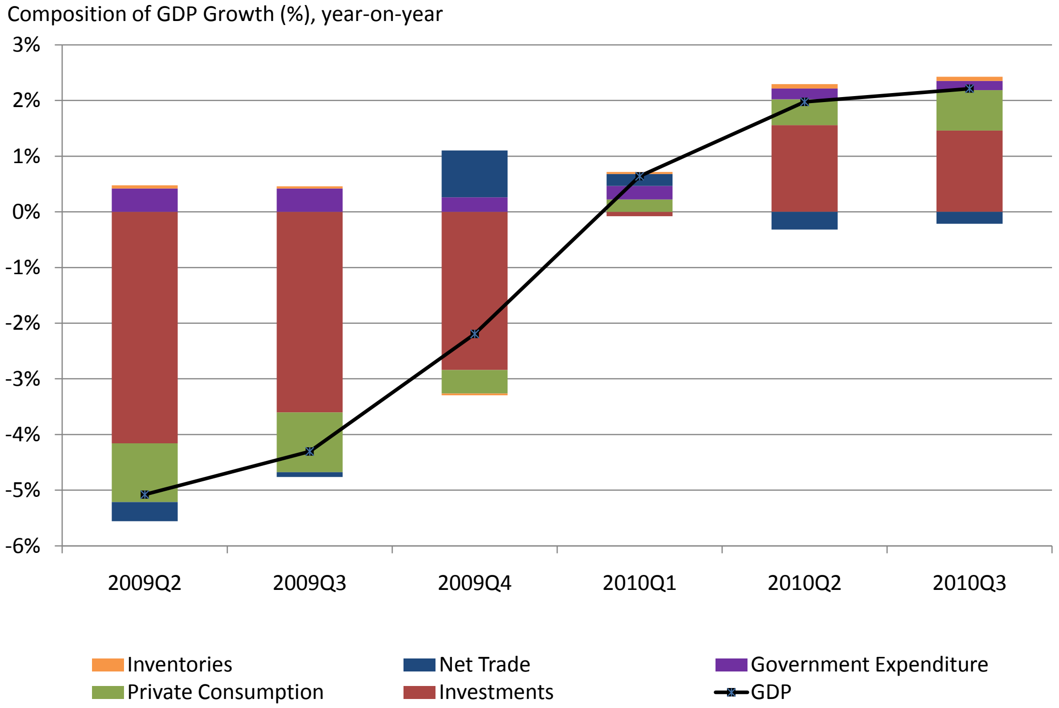


Another positive development, which you can see from the next chart, is that investments have become a key contributor to growth in Europe, generating about two thirds of the European GDP growth in the second and the third quarters of 2010.



However, a note of caution is needed here given that most of the investments seem to be replacement rather than extension – e.g. not really new investments. The increase in investments is partly explained by the massive drop they suffered in 2009 (approximatively -25%). Furthermore current capital spending appears to be largely financed through internal financing. Looking ahead, external financing constraints, linked to persistent dysfunctions in capital markets and rising public indebtedness, will exert downward pressure on the investment recovery, as only companies with strong equity and low leverage positions may be able to finance further investments.

In a nutshell, we see positive results of reform policies, which confirms that these should be pursued, but at the same time there is a concern that this emerging recovery could be stifled by credit constraints.

Obviously, this general picture of recovery masks large country divergences. The so-called "surplus" countries are currently the main engine of growth in Europe, demonstrating a consistent pattern of faster labour market improvements and ongoing rebalancing towards stronger domestic demand.

By contrast, countries having accumulated fiscal, competitiveness and other macroeconomic imbalances are currently facing more intense adjustment and policy challenges in rather difficult circumstances.

<u>The need for a holistic approach</u>

The overall conclusion that BUSINESSEUROPE draws from this brief economic overview is that a holistic approach is vitally needed for ensuring a return to sustained growth, and to dynamic growth financing.

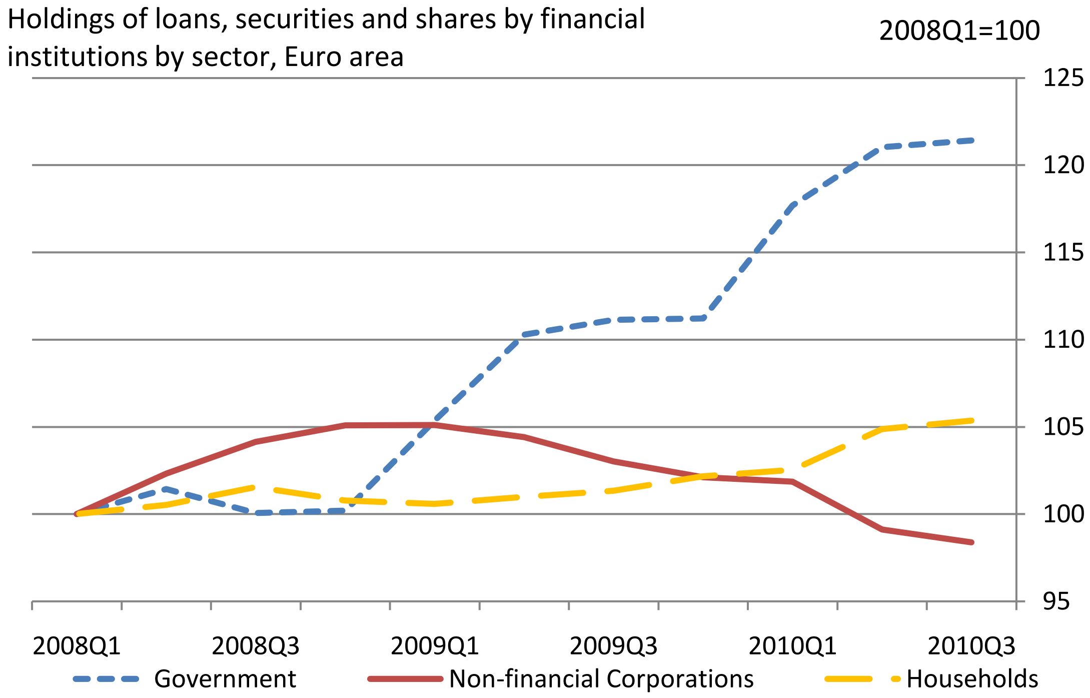
This holistic approach should stimulate sustained but carefully <u>balanced</u> progress towards the following 4 objectives:

- Fiscal consolidation
- The reinforcement of financial stability
- The stimulation of growth
- The stimulation of job creation.

A balanced agenda is needed in particular for financial sector reform. BUSINESSEUROPE supports regulatory initiatives aimed at providing financial stability, and preventing future crises. However, to regain confidence, reforms must be proportionate, strike the right balance, and be mindful of their impact on cost and availability of capital.

For instance, Basel III imposes tighter capital rules for banks, which are clearly needed but will have important consequences for lending conditions, trade finance and hedging activities by companies. New liquidity requirements could create an additional bias towards government debt as opposed to private sector financing, which is considered more risky. This will interact with other prudential rules, such as Solvency II, which already discourages investments in private securities and favours government debt.

The following chart shows that over the recent period large financing needs by governments have significantly crowded out private investment. Between the first quarter of 2008 and the third quarter of 2010, the proportion of public debt in the total assets' portfolio of financial institutions increased by 22%, whereas the proportion of loans, securities and shares of non-financial corporations decreased by 2%. We must avoid that this trend gets out of control.



In order to ensure smart regulatory development, comprehensive impact assessments must be carried out to address to assess the cumulative impact of different pieces of legislation.

<u>An action agenda for facilitating SME access to credit and alternative sources of finance</u>

As credit conditions have tightened, and the lending capacity of the banking sector will remain impaired over the medium term, BUSINESSEUROPE urges that a more ambitious agenda be put in place at national and EU level for:

- Easing access to credit for SME;
- Developing alternative sources of finance for SME.

This should include in particular:

– Increasing the access of SMEs to capital markets, for instance, by facilitating pooled access of SMEs to bond markets;
– Devising better tax incentives for investors, providing equal treatment to debt and equity financing, and encouraging business angels and venture capital.

Regarding the future EU action agenda, I would like to comment more particularly on the promotion of SME development on the basis of EU budget resources, an issue which is currently reviewed by BUSINESSEUROPE.

It's worth recalling that the Small Business Act (SBA) stipulates that the EU and the Member States must facilitate SME access to finance, notably to risk capital, microcredit and mezzanine finance (which often takes the form of subordinate or convertible loans).

Recent years have seen a clear demonstration of the important role that can be played by EU financial instruments targeting SMEs, which seek to address weaknesses or failures in financial markets. This has been highlighted in particular by:

- The Competitiveness and Innovation Programme's (CIP) horizontal "Entrepreneurship and Innovation" scheme which provides financial institutions with funds and guarantees, thereby facilitating equity investment or the grant of loans to SMEs that otherwise might not get the financing they need due to their riskiness or their lack of collateral.

- The "Risk Sharing Finance Facility" (RSFF) put in place by the European Community and the European Investment Bank to foster private sector R&D and innovation (RDI) investment in the EU. In this debt-based finance facility, the EC provides a contribution to the EIB to partly cover its risks when providing loans and/or guarantees for eligible RDI investments.

- Instruments such as JEREMIE (under the umbrella of cohesion policy) seeking to support SMEs and young businesses.

These three financing models have each their own merits; the strong financial leverage effect of CIP and RSFF should be underlined. The three financing models should be strengthened and refined, paying particular attention to making the schemes as accessible as possible for SMEs.

Concerning the future EU financial perspectives, there are strong arguments for shaping policy along the following orientations:

- Reinforcing the weight of SME promotion actions (through the channel of the various relevant EU policies : industrial and entrepreneurship policy, research and innovation policy, cohesion policy, etc.) in the overall EU Budget;

- Paying attention to facilitating access to finance for both

    - innovation-based SMEs and
    - more mainstream SMEs.

- In operational terms, when further refining EU financial instruments, drawing inspiration from best practices observed at national/regional level. Conversely, the design of future EU financial instruments can and should stimulate a modernisation of public schemes in some member states/regions.

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