BUSINESSEUROPE

DECLARATION ON ECONOMIC GOVERNANCE

REFORM IS ESSENTIAL TO RESTORE CONFIDENCE AND GROWTH

POLITICAL COMMITMENT IS VITAL

An ambitious conclusion to the debate on economic governance is essential for the European business community.

Economic conditions have improved over recent months but the sustainability of this recovery will largely depend on governments' ability to restore confidence in public finances and push forward ambitious structural reforms.

This is of immediate concern. Financial stability, investment conditions and job creation in the coming months will largely be influenced by the credibility of such a commitment. This is both an individual and collective responsibility for European governments.

The failures of current governance system have been exposed with dramatic intensity in recent months. The Stability and Growth Pact is in urgent need of repair.

Closer attention to competiveness and macroeconomic imbalances is also warranted, particularly within the euro area. These have proved to be a major destabilising factor and a hidden fiscal liability for the countries concerned.

Greater commitment towards discipline and stability will have to be matched by an equally strong resolve to implement structural reforms. Combining healthier public finances and rising living standards in the years ahead will only be possible if the EU is able to address impediments to a better functioning economy with a renewed sense of urgency and lift its growth potential to at least 2%.

This will require a comprehensive reform agenda stimulating companies' innovation capacity and access to global markets and finance, supporting the skills and employability of people and ensuring the long-term viability of social protection and pension systems.

It is time to step up political responsibility and demonstrate a true commitment to effective coordination in Europe.

AN ACTIVE CALL FOR REFORMS

BUSINESSEUROPE has made detailed contributions to the debate on public finances and economic governance in the EU and euro area, notably through the publication of two reports this year:

- "Combining Fiscal Sustainability and Growth: a European Action plan" in March 2010,
- "Improving euro-area governance, securing the long-term success of the euro" in June 2010

Furthermore, the Council of Presidents of BUSINESSEUROPE adopted the Madrid Declaration "Lasting growth will only be achieved with greater stability" on 11 June 2010.

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

BUSINESSEUROPE a.i.s.b.l

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

On institutional reforms, BUSINESSEUROPE called for the transposition of ambitious debt and deficit rules into national law for every administrative level and for a reform of national, regional and local fiscal institutions. At EU level, we made concrete and detailed proposals on how to reinforce the surveillance of both fiscal and broader macroeconomic imbalances, and impose stricter and more automatic sanctions on non-compliant countries.

We are glad to see a large number of these recommendations reflected in the legislative package proposed by the European Commission on 29 September.

We welcome the Commission's input throughout this process and call on the European Council and the European Parliament to ensure swift progress to finalise the proposed package.

The task force chaired by President Van Rompuy was able to reach a political consensus on a number of fundamental issues and we trust that its report will inspire a clear and comprehensive commitment from the European Council.

OUTSTANDING ISSUES

Important steps have already been agreed upon, in particular the establishment of a European Semester to coordinate fiscal and broader economic policies in a consistent and synchronised framework.

Success will require the Commission to strengthen its monitoring system and draw transparent lessons in country-specific recommendations and warning signals to underperforming countries.

The business community now expects Heads of State and Government to agree on the following key issues during their meeting on 28-29 October:

1. <u>Minimum requirements for national fiscal frameworks</u>: BUSINESSEUROPE supports the need to establish such requirements, including ambitious and clear numerical rules, multiannual fiscal programming and high quality statistics. The Commission should closely monitor national transposition and ensure that it is completed by December 2013 at the latest. To further incentivise institutional improvements at national level, Member States which fail to meet these minimum requirements could be subject to stricter reporting.

2. <u>Pre-emptive sanctions under the Stability and Growth Pact rules:</u> we welcome the introduction of a system of interest-bearing deposits (as suggested in our June report) when euro-area Member States fail to progress sufficiently towards agreed budgetary objectives in good economic times. We think that further work is needed on the trigger for such a procedure (i.e. the definition of "prudent fiscal policy-making" and significant deviation from it). The expenditure rule proposed by the Commission - avoiding government spending to grow faster than a "prudent medium-term rate of GDP growth" - is welcome but needs further clarification. We believe that the public expenditure path consistent with fiscal prudence should consider not only a baseline projection for real GDP growth, but also risks surrounding that projection. "Stress tests" to assess the impact of worse-case scenarios on public finances should be generalised and exposure to adverse shocks appropriately factored in.

3. <u>Debt criteria:</u> An increased focus on public debt when assessing fiscal sustainability is warranted and the 60% of GDP limit remains a fundamental benchmark. However, actual activation of an Excessive Deficit Procedure linked to this criterion should take into account a number of important factors including, among others, medium-term growth prospects, future implicit liabilities, the impact of pension and other structural reforms, and the accumulation of excessive private debt to the extent that it represents a contingent liability for the government.

These elements should be based on a reliable measurement system to be further developed by the Commission and the Council. Regarding the definition of a satisfactory pace of debt reduction, it should create proportionate incentives for all countries including those closer to the 60% limit. The formula proposed by the Commission – foreseeing an average reduction of 1/20th of the gap with the 60% debt threshold per year – does not meet this criterion. It should be further reviewed and include for instance a minimum reduction applicable for countries above but close to the 60% reference value.

4. Automatic procedures: we support the introduction of a reverse majority voting when deciding on sanctions for euro-area countries. This should help reduce the room for political "horse trading" in the Council and therefore ensure better enforcement of agreed rules. Non-compliance with Council recommendations would lead to more frequent and tighter surveillance, and gradual financial sanctions. A detailed conditionality programme, comprising both consolidation measures and structural reforms, should be agreed to allow proper monitoring.

5. Allocation of fines and interest payments: we consider that the foreseen distribution of fines and interest payments to euro-area Member States which are not under excessive deficit or excessive imbalance procedure might raise politically sensitive concerns. Therefore, we suggest envisaging an alternative assignment for these extra revenues, which could eventually be allocated to a permanent crisis resolution fund for the euro area.

6. Improved macroeconomic surveillance: the development of performance scoreboards has been advocated by BUSINESSEUROPE for a long time and is therefore welcome. Such a framework should signal emerging macroeconomic imbalances but also highlight structural growth bottlenecks in a more objective way. This notably calls for the inclusion of key product and labour market indicators in the scoreboard. This surveillance process should be tightly connected to the Stability and Growth Pact, and lead in particular to more ambitious deficit, spending and debt consolidation targets for countries with identified imbalances.

Beyond these measures, it is important to continue working towards a permanent crisis management and resolution mechanism. This should include the possibility of emergency loans with strict conditions and a scheme allowing for debt restructuring and orderly default in last-resort situations. These missing links in the governance structure will need to be further discussed and agreed upon in the months ahead.