FOUNDATION FOR EUROPEAN PROGRESSIVE STUDIES
FONDATION EUROPÉENNE D'ÉTUDES PROGRESSISTES

FEPS

Rue Montoyer 40 | 1000 Brussels (Belgium)

For a Progressive European Recovery Plan

Paper drafted by Maria Joao Rodrigues for FEPS
Any further information can be obtained through the Secretary General of FEPS, Ernst Stetter (ernst.stetter@feps-europe.eu)

October 2009

Table of contents:

Introduction
A special crisis and the European paradox

When the risk of a financial *tsunami* seemed to come from the USA one year ago, Europe had an uncertain hope of being better protected by its sounder macroeconomic fundamentals and its stronger social model. It has soon understood that it was in face of a crisis of historic proportions and the only way to protect itself would be to deploy an unprecedented array of instruments of financial economic and social policy. In the pick of the storm, several downward spirals were at work: wage cuts and mass lay-offs squeezing consumption; a credit crunch blocking investment; many Member States unable to support demand because of higher spreads in their public debts and, in some cases, as a result of IMF conditionality; finally, national protectionist actions undermining the Single Market and Economic and Monetary Union. In the EU average, growth rate in 2009 fell to minus 4%, the public deficit rose to 7% and the unemployment rate in going beyond 10%. Now, one year later, the best outlook is just a sluggish growth with climbing unemployment and uncertain conditions for fiscal consolidation, in spite of the increasing pressure of the ageing trends on the sustainability of the social protection systems.

How can we explain this paradox of the European vulnerability? For two main reasons. First because the European economic model was not protected against this kind of crisis, in spite of certain varieties of European capitalism being more protected than others. Second, because of level of European integration and interdependency already reached, national policies alone are no longer sufficient and can even be counterproductive when addressing this kind of crisis.

Therefore, if we want to define and assess the European policies, not only to control and mitigate, but also to overcome and to prevent this kind of crisis, we need first to understand its real nature as well its implications for the European integration.

This is systemic crisis of a market economy which has been driven by the share value, by the short term financial return as the main criteria, sacrificing productive investment, growth, jobs, wages, environment and general well being. This is a systemic crisis requiring key transformational reforms for the emergence of a new development model. The crisis can also be viewed as a historic opportunity to bring forth transformational change in our economies, leading the way for more sustainable and socially fair long-term development. We should build a financial system supporting the real economy and the transition to a smart and green economy; a generalised lifelong learning system to support the transition to new and better jobs; an active welfare system providing services and income support throughout the life-cycle. We should achieve radical change in the way we produce, distribute and consume energy in the interests of the planet. Changes in governance - corporate and public - are required to ensure this transformation.

This is also a global crisis, which started in the USA and swiftly spread throughout the world, with the financial crisis feeding in the economic crisis and the social crisis and the other way round. Underlying this crisis there are major economic and financial imbalances: American growth depending on external credit, Chinese or other emerging economies fostering their exports to the detriment of their internal demand, too many countries still in an underdevelopment trap, a very uneven distribution of the benefits of globalization across the world and within each country. A Global New Deal should be settled for a better international balance allowing to raise the global demand in a sustained way and making globalization work for all.

Finally, this crisis is coming on the top of another crisis. This financial turmoil has emerged in a special moment of our history when the gap between global problems and governance was already becoming evident in several areas: a multilateral deal for trade and development is still in pain to be born, migrations flows are expanding without concerted management and climate change is still without the appropriate response. In this particular juncture there is a unique window of opportunity, with a clear choice:

- Either each country retrenches in an individual and isolationist and reaction, by hindering trade, de-regulating financial markets, postponing the transition to a low carbon economy and reducing development aid because they seem too expensive for public budgets. The final and general outcome will then be sluggish growth, inefficient financial system plus uncontrolled climate change;
- Or there is international cooperation to sustain demand, growth and jobs exactly by opening trade, fostering the transition to a low carbon economy and supporting developing countries catching up. National protectionism should be replaced by global protection.

A coordinated European position is now crucial. We should therefore establish, as a matter of urgency, a stronger and more progressive European Plan to overcome the financial and economic crisis, coupled with joint action with the EU's international partners namely in the G20.

More Europe is also needed to support all Member States when coping with their national problems. **National policies are no longer enough** due to the level of European and global interdependence we live in. Isolated national measures of macro-economic, industrial policy or social policy can undermine the Economic and Monetary Union and the Single Market. If we want to have a pro-growth macroeconomic policy and an active innovation and industrial policy, to strengthen our social protection systems or to move to a low-carbon economy, we need to coordinate these policies at European level and to complement them with new European instruments. We also need a more coordinated European voice in the international fora.

The crisis is not over and the recovery is still fragile because unemployment is still rising, industrial restructuring is going on, the fiscal packages are coming to an end, banks' credit was still not fully restored and it is not even clear to what extent the current GDP rebound is due to demand rise or to re-stocking. Moreover, if want not only to control and mitigate the crisis, but overcome it and to prevent it in the future, with the double concern of sustainable development and social justice, we need to go further with a comprehensive and progressive European Recovery Plan.

This paper builds on previous versions which were submitted to a large debate across Europe and aims at identifying the key political priorities as well as assessing the main progress and shortcomings in the way for a stronger, more sustainable and fairer recovery process.

(THE SHORTCOMINGS WILL BE PRESENTED IN ITALIC)

A comprehensive and progressive European Recovery Plan requires:

1. A coordinated response to the recession, combined with an ambitious longer-term strategy for smart and green growth and jobs;
2. Swift action to activate and regulate the financial systems:
3. International cooperation for a more balanced development at international level.

We need stronger coordination between Member States regarding these three priorities and a stronger political Europe to implement such a progressive response to the crisis. A common "tool box" is no longer enough. We need to have a common European framework, stronger European coordination and stronger, more effective European instruments.

1. <u>A coordinated response to the recession</u>

A stronger European response to the recession should focus on the following objectives:

- Safeguarding employment and preventing mass unemployment by counteracting the slowdown and supporting demand by households and companies;
- Creating new jobs while promoting transformational change for a smarter and greener economy, thereby meeting long-term climate goals;
- Protecting people, especially lower income groups, and their jobs as well as supporting their move to new and better jobs.

The European response to the recession should combine a budgetary stimulus, more ambitious policies to promote structural change and social policies providing more security in change as well as stronger action to activate bank lending.

A stronger European Recovery Plan should be connected with the definition of the post-2010 Lisbon strategy, enhancing the growth potential and paving the way for a deeper economic, social and environmental transformation.

This should be a central priority for the new term of the European Commission and the European Parliament as well as the upcoming Presidencies

The internal cohesion of the Single Market should be safeguarded when implementing this joint European recovery plan. This means that state aids to struggling sectors, suffering massive job lay-offs, should not result in unfair competition and should ensure equal treatment to cross-border branches. But the best way to prevent the risk of national protectionism is to strengthen the role of European funding instruments, including the Structural Funds, the Globalization Fund and community programmes, strengthening the European innovation, industrial and employment policies. Moreover, Member states should have the means to ensure the social protection and the active labour market policies necessary to cushion the industrial restructurings which will be triggered by the crisis.

All this will require more coordination of macro-economic policies. The Economic and Monetary Union, as another major asset of European integration, will only be safeguarded on four conditions:

- that Member States improve the coordination of their budgetary policies, including tax policies;
- that the room of manoeuvre of the revised Stability and Growth Pact is fully used;
- that European instruments are further developed, to enable all Member States to support demand;
- and, finally, that non-eurozone Member States are better protected against speculative attacks on their currencies.

The political choice is now clear: either we strengthen European integration to combat this crisis or this crisis will undermine European integration.

The connections between this crisis and the European integration are not being fully addressed so far.

1.1. A budgetary stimulus for growth, jobs and structural change

Employment should be central for designing the European budgetary stimulus. In order to take advantage of the European spill-over effects on growth, Member States should coordinate their economic policies, including public investments, fair and effective tax incentives, and incentives for private investments, according to a common set of priorities. The precise policy mix should be decided by each Member State according to criteria of effectiveness and fairness and to national specificities, notably levels of debt and deficit and the scope of its problems.

The priorities for the recovery to be defined in the framework of the Lisbon Strategy should become the drivers of an investment strategy focusing on:

- Speeding up the construction of new energy and broadband networks;
- Promoting the greening of products and services, including houses and cars;
- Developing comprehensive programmes to support SMEs;
- Improving the coordination of research and education programmes with innovation in new areas of investment and job creation;
- Supporting existing jobs while helping to retrain the existing workforce, such as schemes to enable employers to prevent job cuts through "intelligent work-sharing", combining reduced working time with publicly-subsidised training programmes;
- Providing tailor-made access to new skills for new jobs, including education and training programmes for the unemployed;
- Supporting the development of family care services and infrastructures. This can include maintenance work.

The projects to be supported should be timely, targeted, have an immediate impact on job creation and be consistent with long term goals. Public procurement rules should also be adapted in order to speed up the implementation of projects.

The level of horizontal (various policies) and vertical (between Member States) coordination of the macroeconomic policies according to these priorities is still very insufficient.

What is a good stimulus package?

- it is more about investments and less about consumption, to improve productivity and to use multipliers;
- it should be timely, targeted and temporary; we emphasize especially that implementation has to be timely to work against the crisis;
- it should lead to more sustainability;
- it should be financially efficient, and therefore rather about loans and guarantees than about grants; on average loans and guarantees are, to a very high degree, self-financing and reduce therefore the burden for future generations significantly;
- and it should have the size to create the necessary impact in order to make the crisis less deep and achieve an earlier recovery. The size of the European budgetary stimulus in 2009 and 2010 should be determined by the need to safeguard employment. Such a stronger budgetary stimulus – driven by the 13 biggest economies in the EU – should make it possible to return to the pre-crisis employment level within the next 4 to 5 years, by using the spill over effects of each country growth supporting the others.

Various instruments of public finance should be adapted for this central purpose:

a. In the framework of the revised Stability and Growth Pact, Member States, able to redirect their public expenditure and tax structures, should be allowed to run higher public deficits, provided they can demonstrate that this will contribute to higher growth and a consolidation of their public finances in a longer time frame. This approach should also be taken into account when applying the excessive deficit procedure. To achieve sustainable public finances in the medium term and avert an unacceptable debt burden for future generations, the choice today is not just between raising or cutting taxes: it is between slow growth damaging the life chances of many, or investment in a sustainable and prosperous future with real job prospects for all.

The flexibility of the revised Stability and Growth Pact has been used but Member States are in very unequal conditions to provide a fiscal stimulus
The instruments to assess the redirection of public finances are still very insufficient.

b. Selective tax incentives should have as their primary purpose to stimulate domestic demand in a socially fair and effective way, leading to actual increases in consumption. The following measures could be considered: tax incentives for green products and services and for labour intensive services such as personal or catering services or reductions in the tax burden in lower incomes or in some basic products. The EU should adopt a bold package of green tax measures in this context.

The shift towards green taxation has not taken place yet.

c. State aids to struggling sectors, suffering massive job lay-offs, should not result in unfair competition and should ensure equal treatment to cross-border branches. A new European framework to promote innovative and sustainable industrial development should be developed, generating synergies between new national efforts and ensuring their consistency with the Internal Market.

A European industrial policy ensuring better coordination of state aids is still at a very early stage

d. Implementation of the Structural Funds, the Cohesion Fund and CAP needs to be stepped up by reprogramming and frontloading financing. Implementation should also be streamlined and refocused in line with the common set of priorities mentioned herein.

   In spite of several simplifications, some administrative and financial obstacles are still hindering a more effective implementation of the Structural Funds. Moreover, they can leverage more investment if they can also be used to subsidized interest rates

e. The Globalization Fund should widen the scope of its action not only to respond to lay-offs connected with globalization but to prevent them through proactive action, to be reflected in the current Commission proposal for revision being considered.

f. The capital base of the European Investment Bank should be strengthened again to go further in its support for investments in infrastructure, green technologies, innovation and SMEs.

This was already decided, but the EIB loans should create more leverage for private investment by providing guarantee instruments.

g. The European Central Bank must continue its efforts to support the recovery in the eurozone through its monetary policy, including timely interest rate cuts, and across the European Union through all other relevant measures.

This crisis has made clear that the ECB responsibilities are not only about inflation but also about growth and employment. Its interventions were and should remain very relevant in this direction.

h. Member States should consider new tools to issue public bonds. In the present context, characterized by international competition for financial resources, it could be useful to examine the possibility of converting national bonds into Eurobonds. The aim would be to reduce the spreads which are being paid by public debt to launch new investment projects, supporting business in general by decreasing the cost of capital, and attracting domestic and foreign savings and preventing hostile takeovers by foreign investors. A European agency could be created to organize the common issuance of EU denominated bonds, with the guarantees to be provided by all participating Member States.

This important instrument is still waiting for an institutional initiative

i. Trade policy must also play a role in the recovery, through the conclusion of the Doha round and European Partnership Agreements, as well as promoting the export potential of Europe's small and medium sized businesses.

The Doha Round conclusion is still blocked

j. The Community budget should be adapted to contribute directly to the immediate need for economic recovery, starting with the proposal for the 2010 budget and then also in the forthcoming mid-term review of budget.

Still waiting for an institutional initiative. The new financial perspectives should be consistent with an ambitious recovery and long-term strategy for sustainable development as the post-2010 Lisbon strategy

Finally, the recovery is also strongly dependent on restoring bank lending (see section 2.1). The aim of a successful and sustained recovery should be to mobilize as much private funding as possible and to add as much public funding as necessary.

The exit strategy regarding this special fiscal stimulus overburdening the national budgets needs to put the central focus on increasing the growth rate and growth potential, as a pre-condition for the longer term sustainability of public finances. Therefore:

- A early withdrawal of the fiscal stimulus should be avoided until the drivers for a sound recovery are confirmed
- The public expenditure cuts and the tax increases should comply with social justice and should avoid to over-burden the labour factor. A shift to green and financial taxes should become a clear priority
- The pace to reduce the fiscal stimulus should be differentiated and adapted to national specificities, under two conditions: on the one hand, a convergence regarding social and green taxes and, on the other hand, stronger European instruments for regional development.

1.2. More ambitious policies for smart and green growth

The recovery plans in the US, China and a small number of EU member states are the biggest investment packages ever established in such a short time span. The scale of the crisis presents a unique and historical opportunity to bring forth transformational change in our economies, leading the way for truly sustainable and socially fair long-term development. It is therefore crucial that the European economic recovery programme meets this central purpose.

Even in recession, Europe can create jobs in many sectors: retrofitting of houses, developing and installing renewable energy production units, spreading low carbon technologies, efficient and electric cars, strengthening public transport, smart urban planning, health and care services, personal services, business services, biotechnologies and nanotechnologies, creative and cultural industries and modernizing manufacturing sectors according to new standards of energy, design, safety and quality. This will be particularly important not only to offer job opportunities to a higher-skilled young generation entering the labour market, but also for workers who are losing their jobs in sectors undergoing restructuring. Saving energy and raw materials in the manufacturing and service sector makes the European economy more independent, reduces costs and makes European products more competitive. Environmental and climate conscious customers represent an increasing market, which Europe cannot afford to ignore.

1.2.1. Smarter growth

For the recovery to bring transformational economic change to the European economy and create more and better jobs, there must be better coordination of innovation, industrial, research, education and retraining and employment policies at all relevant levels:

a. Member States should improve the coordination of these policies, in particular to support regional partnerships for growth, innovation and jobs as well as cross border initiatives.

b. At European level, a single strategic platform should be created for bringing together all key actors to work together on growth, innovation and jobs in each sector and to coordinate existing instruments: technology platforms, skills expert panels, joint technology initiatives, lead markets, clusters and high level industrial groups.

c. Research and development needs to be better supported and more targeted on the technologies of the future. More emphasis must be put on the marketability of new developments, Europe-wide legal standards and subsidies must be used in order to support mass production of new technologies.

d. Regarding infrastructure for a smarter economy, a European broadband network should be extended to all regions, allowing access to the latest generation of Internet platforms, by combining private and public resources, at national and European level.

The current policies are still far away of this level of ambition to promote a knowledge-intensive economy which was at the heath of the Lisbon strategy.

1.2.2. Greener growth

The fight against climate change demands a fundamental shift towards a low-carbon economy, generating important new opportunities for more and better jobs and social fairness in our societies. Climate change is happening at an even faster pace. Bolder action is now needed to avert dangerous climate change and irreversible damage to the planet, to our economies and our societies, with a window of opportunity of just a few years before dangerous climate change becomes inevitable.

The European Commission has estimated that to achieve the EU's climate targets of 20% emissions reduction by 2020 – which would be raised to 30% if a post-2012 global climate deal is achieved - there will have to be public and private sector investment of approximately one trillion euro from now until 2020. One EU-funded study has estimated that climate-related investments of EUR 3,145 billion by 2030, would result in the creation of between around 300,000 to almost 900,000 new jobs annually.[1] Increasing energy dependence on countries outside Europe and rising energy prices point to the need for an urgent push towards energy efficiency and renewable energies.

[1] "Climate change and employment: Impact on employment in the European Union-25 of climate change and CO2 emission reduction measures by 2030"; European Trade Union Confederation (ETUC),Instituto Sindical de Trabajo, Ambiente y Salud (ISTAS), Social Development Agency (SDA), Syndex Wuppertal Institute, 2007.

The recovery must be used to simultaneously fight climate change and create new growth and jobs. A new European framework for innovative and sustainable industrial development could thus prove vital.

"Green" economic measures for the recovery could include immediate implementation of the following measures:

- Provide tax credits/government premiums and redirect EU structural funds to support energy efficiency related household investments (high energy efficient heating systems, building isolation, more efficient electronic devices) and to support renewable energy production for personal use.
- Regulation and subsidies supporting the installation of renewable energies (feed-in tariffs, direct support to carbon free power plants, support energy infrastructure).
- Investments in sustainable transport and tax credits/government premiums for cleaner cars.
- Credits from the EIB for renewable energy and energy efficient projects.

The sustainability, independence and security of Europe's energy supplies will depend on large-scale investments in our energy sources, distribution and infrastructure. The following investment areas have huge potential for promoting, jobs, growth and long-term prosperity:

- Power generation and storage: Renewing electricity power generation capacity, including renewable energies, will require an approximated 17 billion euro in the next five years. There will need to be high investments in developing gas and electricity networks. All these infrastructure projects will create high-value jobs.
- Cross-border energy networks: important cross-border projects are an important component of these investments needs.
- Energy efficiency: the EU is committed to improving energy efficiency by 20% by 2020. In order to achieve these targets and bring considerable cost savings to Europe's businesses, households and the public sector, investments and tax incentives are now needed to renovate public and private buildings and housing, increase the efficiency of lighting, heating and cooling systems, and promote new technologies for energy efficiency in goods and services.

Europe should also examine in much greater depth how green investments can be financed through new green revenues, for example green taxes. Furthermore, the revised Emissions Trading Scheme will provide a significant new source of revenue, on a scale that will depend on the price of carbon at auctioning. These revenues should be invested in generating new green growth and jobs.

The European Recovery Plan should be more strongly connected with smarter and green growth.

Even if the international framework for low-carbon growth will depend on the Copenhagen Summit, the European Union should move quicker in this direction, in order to keep its leading position.

1.3. Social and Employment Policies to provide more security to change

Social and employment policies should be adapted to cope with the recession. It is important to safeguard jobs as far as possible, support the unemployed back into employment as fast as possible and stimulate the creation of new jobs. This crisis should also be seen as an opportunity for a European-wide radical re-skilling of the labour force. Above all, fairness in the response to the recession should be our main guiding principle and a special concern should be kept for the most vulnerable. A **European Employment Pact** and **Social Progress Pact** should be developed as two major pillars of the recovery plan. The priorities should be:

1

a. To launch **programmes for job creation** in the priorities already identified in point 1, combining public and private investments, notably structural funds, EIB and Eurobonds. These initiatives should promote access to new jobs, particularly amongst young and older workers, and will require stronger proactive action, based on a better coordination of labour market, education and innovation policies. Attention should also be paid to facilitating entry into the labour market for young people – for example through large-scale support for internships and apprenticeship programmes – and tackling the increased risks of age discrimination in the labour market.

b. To launch a European-wide programme for "**New skills for New jobs**" to ensure a massive re-skilling for new jobs. This programme should be financed by public and private spending to be coupled with a refocusing of the European social fund, providing tailor-made solutions for education and training to those who will need a "knowledge lift" to get a new job or keep their existing one. This programme requires not only building a European co-ordinated system to anticipate skills needs but also to develop the European frameworks (EQF and ECVET) to support the transfer and accumulation of learning outcomes. Finally it also requires widening access to competence assessment centres as well as to new funding instruments for learning activities (learning accounts, social contributions, loans and scholarships).

c. Schemes to enable employers to prevent job cuts, such as "**intelligent work-sharing**" combining reduced working time with publicly-subsidised training programmes, should be implemented. These schemes should, if necessary, be coupled with reduced contributions to the social security. Other forms of internal flexibility should be explored in the framework of social dialogue and enhanced social corporate responsibility.

d. Monitoring and supporting **wage developments** to ensure sustained private consumption. Common principles could be agreed, based on the dual need for wages to be aligned with productivity gains and to protect purchasing power. Wage reduction schemes should be closely monitored, ensuring that they are necessary and temporary, and, where appropriate, linked to social security support and sector-relevant skills training. The Social Partners have a key role to play.

e. Strengthening the **monitoring of the restructuring process**. To submit planned mass lay-offs to a stronger supervisory scheme, ensuring that all other alternatives have been exhausted. Restructuring processes which are inevitable should be supported by social plans and programmes for regional development, which could be financed by EU Structural Funds and the Globalisation Fund. Companies that receive state aid should reimburse it in cases where they have laid off staff while at the same time using their financial resources to pay dividends to shareholders or buy company shares to increase share value.

f. To renew social, employment and education policies and services focused on **unemployed people**. Strengthen unemployment insurance, when needed, and significantly scale up active labour market policies which should come into play as early as possible following redundancy (under 3 months). Modernise and strengthen unemployment services, offering a range of support and re-skilling programmes, developing closer relationships with local employers and providing information on access to entrepreneurship opportunities. Support the social economy to provide new opportunities to the unemployed.

g. Targeted policies must be established or reinforced to support those **most affected by the crisis**, including those on the lowest incomes, at risk of home repossession, lone-parent families, the young, the pensioners. We must promote social justice while having an immediate impact on consumer demand for the recovery. Special measures need to be developed for those being made redundant from precarious jobs benefiting from few social rights. Discrimination against posted or immigrant workers should be combated. Inclusive labour markets, access to public services and minimum income should be kept as basic principles.

h. To establish specific measures for the **housing market**, such as: reducing the cost of mortgages, supporting first-time buyers, protecting against repossession, and promoting the social housing sector.

i. To develop specific measures to support **lower income groups** during the recession, including income support (for example, cuts in the social security contributions to be paid by employees, targeted tax cuts and credits, including income tax rebates) and policies to ensure the affordability of basic goods such as electricity and gas.

j. Protect **pensions and savings**. Priorities should include the protection of savings by guaranteeing bank deposits – a general measure already agreed at EU level –, a better assessment of financial products, for example through the implementation of consumer information and protection measures, and ensuring the adequacy and sustainability of pension schemes in the three pillars of the social protection system, particularly the first pillar. In this respect, a review of regulation relating to the governance and investment of second and third pillar pensions should be undertaken.

k. To make investments in services which meet employment and social objectives, including **family care services and infrastructures**.

The unemployment problem is being underestimated by the current policies. Up to 10 million jobs could be lost over the next two years and it will take many years to reach the per-crisis employment level again. The limited actions adopted so far will not be sufficient to meet this challenge. The support to part-time work has been important to avoid many lay-offs but:
-More needs to be done to proactively create new jobs. Creating an environment friendly for entrepreneurship and assisting young people and unemployed to start an own business will not be sufficient in this. We need to activate labour demand and not only labour supply.
- The social consequences of the crisis will also become deeper. Poverty and social exclusion will rise in the coming months and national welfare systems will increasingly come under pressure. Specific measures need to be developed to address these challenges.

On the longer term, the policy mix of social policies should be adapted to the new labour demand and supply trends. The structure of employment is undergoing a major redeployment towards new activities, due to the new context created by the transition to a knowledge intensive economy and a low carbon economy, by the European integration process and by a faster globalisation, where emerging economies are competing across the board. At the same time, the structure of the labour force is also undergoing a major re-composition due to the ageing trends, the immigration flows, the education trends and the emergence a new family types.

Against this background, a stronger priority should be given to the political orientations which can address these challenges by enhancing competitiveness and social cohesion simultaneously. This is notably the case of the following orientations:

-Developing skills by raising the education levels and spreading the access to lifelong learning, with a particular focus on activities where more and better jobs can be created;

- Supporting professional transitions with an employment insurance and social drawing rights

-Developing flexicure labour markets for all, using internal and external flexibility and encouraging social dialogue;

-Developing family friendly policies to improve the conciliation between working life and family life over the life-cycle;

- Spreading active ageing with later and flexible retirement and keeping adequate, adaptable and sustainable pensions;

-Promoting active inclusion with active labour market policies, minimum income support and better access to social services;

-Strengthen external action of the Union to promote jobs, improve global social standards and managing migrations, ensuring better social integration.

2. Swift action to activate and regulate the financial systems

2.1. Urgent measures for financial stabilization to protect saving, investment and jobs

Restoring bank lending and promoting good banking, is crucial for a quick, sound and lasting recovery. The concept of "good banking" can be defined by a set of criteria such as developed retail services, strong deposit business, diversification, closer relationships with customers, a leverage cap and striking a right balance between efficiency and safety. This concept should become a driver for the unavoidable restructuring process which should be carried out in the banking sector. A long term strategy to strengthen and developing good banking meeting the real needs of citizens and business should frame the public intervention in this sector.

The measures already adopted to avoid the financial meltdown are still not completely implemented and are crucial to re-activate the interaction between the financial system and economic activity, which is at core of this crisis. Besides guaranteeing deposits, ensuring more liquidity and supporting inter-banking lending:

- Restructuring bank balance sheets in order to isolate the effect of the impaired assets. "Bad banks" and insurances can be considered but in other cases, recapitalizing banks will be necessary. In any case, clear conditions should be set for them to get public support: presenting restructuring plans and ensuring transparency, equal treatment of their cross border branches and fair cost-sharing between taxpayers and shareholders, the latter being ready to shoulder an important part of the burden of losses;
- Recapitalizing banks by bail-out of creditors or by debt-for equity swaps. Appropriate conditionality should be set including maintaining their credit lines to companies and households, rationalizing executive pay and complying with the improved regulation of the financial system. Government representation in the board can also be considered up to the necessary level;
- Most of all, pressing all banks to play their role of providing credit to companies and households in order to sustain the level of economic activity, investment and job creation at local and regional level. The incentives for bankers, traders and fund managers should revised in order to change their behaviour: their bonuses should be assessed over a longer period and involve stock-options;
- Special credit facilities should be created for SMEs to be provided, if necessary, by regional industrial funds;

In spite of the already adopted measures, the credit level remains very insufficient to overcome the recession. It is important to recognize that the problem is not only of liquidity *but, in several cases, of solvency. Therefore, stronger measures are needed to tackle this crucial bottleneck and they should be based on making banks accountable for their situation and setting a limit for the tax payers contribution. Moreover, the stress tests to banks should comply with a European Framework and lead to the presentation of public conclusions.*

Targeted interventions to support more vulnerable Member States which do not belong to the euro-zone are also required to ensure European solidarity.

Some non-eurozone member states, especially among central and eastern European Member States, are especially vulnerable to the crisis and are being hit particularly badly. Specific issues include the pressure on their balance of payments and the devaluation of their currencies; the drying up of liquidity with bank headquarters focusing on their home markets rather than in their subsidiaries in Central and Eastern Europe; the devaluation of government bonds; and a much lower room for fiscal manoeuvre to stimulate the economy.

The crisis could have extremely negative economic and social consequences in many of the new Member States, substantially slowing their convergence with the EU-15. Spill-over effects could also occur, affecting the euro and the economies of the euro-zone. The European Union should take the initiative for coordinated, stronger support for Member States in difficulties. Therefore, strong actions are required for European solidarity, to protect the euro-zone and strengthen the internal consistency of the European Union.

First of all, the European framework to respond to the crisis should ensure equal treatment of all Member States: the support given to banks in their headquarters should be extended to their cross-border branches and subsidiaries.

Second, the rescue package to support banks in these countries, provided by EBRD, EIB and World Bank should be increased.

Third, the financial resources of the Community Facility should also be increased, providing medium-term assistance to Member States which do not belong to the euro-zone and have difficulties with their balance of payments. Within this Facility, the European Commission can borrow in the markets EU denominated bonds and provide financial assistance to these Member States. The intervention of the Facility and the IMF - if indispensable - in these cases should be coupled with an appropriate revision of conditionality in order to create room for manoeuvre for recovery.

Finally, the better protection against speculative attacks will be to step up the pathway to join the euro zone. This could be done by admitting some of these countries into the European Exchange Rate Mechanism (ERM II) and by re-interpreting the benchmark of best-performing countries on inflation. The ECB should also examine all possibilities at its disposal for supporting non-eurozone Member States.

A deeper assessment of the measures already taken is necessary to safeguard European cohesion

2.2. Regulating the financial system to support growth and sustainable development

Tackling the economic recession must be our priority, but this must be combined with better regulation for stable, transparent and efficient financial markets at European and global levels. In the absence of this tandem of action, we will see very soon a dramatic downward spiral between recession and financial turmoil, potentially leading to an economic depression.

This crisis has revealed fundamental market failures, resulting in a dramatically spiralling recession and unemployment. Systemic risks cannot be avoided by relying on diversification. The European Union urgently needs a fully functioning transparent, efficient, cost effective and stable financial market, as a precondition for meeting long-term goals in the public interest, such as the Lisbon strategy and fighting climate change. Therefore full scale reform of the financial markets is vital.

The purpose of regulation should not just be to prevent market instability. Regulation must now ensure a close and efficient link between financial markets and the real economy. All financial players and instruments should be covered by regulation for transparency, efficiency and stability.

The financial markets should be reformed on the basis of the following pillars:

I. Monitoring and supervision

- Stronger European supervision and more cooperation between all European national regulatory bodies. Supervision is fragmented and therefore quite ineffective in Europe. In this crisis, supervisors had no global, horizontal overview of what was happening and hence no consensus on the real problems, for example in relation to non-regulated excessive leverage.
- There is a fundamental need to build a macro financial surveillance to monitor and identify operations of financial market players which could cause systemic risks. This implies a more operational approach, an integrated system with access to relevant data. The aim is to create a real "chain" of warnings, that is precise warnings to central banks and supervisors which would then entail action. The De Larosière report recommendations should be swiftly implemented
- The actual system should be reversed: risk should be observable from the beginning and associated with clear responsibility. Financial institutions need to bear some of the lending risks themselves in future. Measures should be in place to promote an effective interplay between sovereign wealth funds and efficient and transparent financial markets. The IMF code of practice on sovereign wealth funds provides a good basis for action.

II. Better regulation of all financial institutions

- Universal legislation covering all financial players. No financial market player should be left out of the system, notably hedge and private equity funds.
- A new strong standard of transparency and disclosure for all financial players. This has to be done in an efficient and comprehensive way and is a first step towards efficient regulation. Transparency and disclosure will allow regulatory authorities to track in a better way the actions of financial players. Transparency is a means to better regulation and not an end in itself.
- Mandatory “capital requirements” for all financial players. Capital requirements must accurately reflect risk, with higher minimum capital ratios, proportional to risk and complexity. This also applies to long loans to hedge funds and private equity.
- Mechanisms to avoid pro-cyclicality should be introduced, ensuring that banks increase capital and provisions in the good times. Rules to prevent excessive borrowing should be introduced. New and more transparent financial accounting standards are needed so that operations are clearly stated in balance sheets. The convergence of accounting rules between Europe and the USA needs to move faster and will contribute to tackle off the balance sheets.
- Limits on executive pay and remuneration as well as mechanisms to ensure that earnings reflect losses as well as profits should be established.
- New rules are needed to prevent conflict of interests.
- All short-selling should be properly regulated. Detrimental short selling that exacerbates crises should be curbed by regulatory authorities.
- Credit rating agencies have always relied on credibility. This has been damaged. Their role and accountability must be reassessed. The establishment of a European credit rating agency would be a means to develop competition and re-establish market credibility in this seriously affected sector. It could also provide registration and oversight of rating agencies. Credit rating agencies are amongst the financial actors with the highest profit margins: in addition to the two ratings they have to provide, they should provide a third rating free of charge. In addition, we should examine how to broaden rating measures.

III. Better regulation of financial products

- For credit default swaps, a transparent clearing house should be set up.
- A European public classification of products, including derivatives, should be established.
- Issuers of securitised products should retain on their books for the life of the instrument a meaningful amount of the underlying risk (non-hedged).

IV. Pensions and savings

- National and European rules must obtain better protection of wage earners’ pension savings through funds with fiduciary responsibility.
- National and European rules must be tightened to better protect wage earners’ pension savings through funds:

- With fiduciary responsibility;
- By prohibiting investments in high risk, opaque products and vehicles;
- By ceiling the share of the fund dedicated to financial markets;
- By creating incentives to invest in long term loans and financing public investment;
- With guaranteed interest rates.

V. Protecting workers' interests

- Regulation should ensure that employees are informed and consulted during all takeovers including those that are leveraged, comparable to that provided for during mergers by Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

VI. Tax havens and off-shore financial centres

- Unregulated tax havens and off-shore financial centres must be covered by regulation through a new international initiative. Europe must lead the way in fighting tax evasion.
- Co-ordinated efforts should be intensified in relation to poorly regulated or uncooperative jurisdictions to:
  - Enhance cooperation in exchanging information on tax evasion with other supervisors and authorities;
  - Provide prudential information or information related to activities to fight money laundering and terrorism.
- At the European level, supervisors should increase capital requirements for those financial institutions investing in or doing business with poorly regulated or supervised financial centres whenever they are not satisfied by the due diligence performed or where they are unable to obtain or exchange pertinent information from supervisors in these offshore jurisdictions
- At the International level, the Financial Action Task Force (FATF), OECD and FSF should propose a toolbox of possible sanctions.

The G-20 adopted a new control mechanism regarding tax heavens, agreed to develop international rules by the end of 2010 to strengthen the quality of bank activity and mitigate pro-cyclicality; it also stated that bonuses should avoid excessive risk taking, be aligned with long term value creation and be subject to claw back, be transparent. In September 2009, The G-20 agreed to work on an international framework for a transaction tax.

In the meantime the EU has amended the capital requirements directive and is discussing new regulatory instruments on hedge funds, investor compensation schemes and market abuse as well as the new regulations creating the European Systemic Risk Board, the European Banking Authority and the European Insurance Authority. The final content of all these new instruments *will decisive to define the kind of reforms which will be introduced in the financial systems: either the transformational reforms it is requiring or just adjustment reforms to keep business as usual*

3. <u>International cooperation for a global response to the crisis and sustainable development</u>

The global nature of the financial and economic crisis demands swift, joint international action. EU Member States should agree on a strong, common European position for international negotiations, notably in the G20 process. Again, restarting banking activities, regulating the financial system, coordinated fiscal stimulus, supporting developing countries, promoting the necessary structural adjustments and reforming global governance should be the strategic priorities. Specific priorities are presented below, in addition to a stock-taking of the important G-20 Summit held in London on 2nd April:

a. Tackling the recession by strengthening the recovery plans and their international coordination, making the best of their spill-over effects and ensuring their consistency with the long term goals of sustainable development.
   The G-20 Summit launched a preliminary coordination of the recovery plans –the global plan for recovery- but could not agree on increasing the fiscal stimulus except for developing countries.

b. Restoring bank lending to business and people according to a common framework ensuring clear conditionality for public support.
   The G-20 summit agreed on a common approach to this central problem but many details are still to be clarified, including the method for stress tests.

c. The afore-mentioned principles to improve the regulation of the financial system should be extended worldwide, if the G20 process is to be successful.
   The G-20 Summit has agreed on many of those principles but it is now necessary to ensure not only their implementation but also the full coverage of all financial operators, including private equity funds and hedge funds. Finally, the actions taken against tax havens should be carried out systematically.

d. The core competences of the IMF and FSF (Financial stability Forum) must be enhanced in order to raise the effectiveness of crisis prevention measures and early warning. In order to move towards a real Bretton Woods II Reform, we can no longer continue with the “soft” regulation of Basel II. In the long term, we need a global regulatory framework to improve financial market efficiency, ensuring macro-financial stability, micro-financial stability, investor protection and consumer protection. The international management of currency reserves should also be reconsidered. All countries should comply with this regulatory framework.

The G-20 Summit established a new Financial Stability Board (FSB) with a larger composition and stronger mandate. Together with the IMF, the FSB should provide early warning of macro-economic and financial risks. The issue of currency management reserves was not discussed.

e. The IMF has traditionally been a liquidity-providing institution. We need to increase its resources very substantially in order to strengthen its capacity to rescue default developing countries and emerging economies and provide them with short and long term credit. Conditionality must be revised in order to promote the economic recovery, support their trade and counter-cyclical policies. Additional funding can also be provided by increasing the issuance of Special Drawing Rights (SDRs).

This is the area where the G-20 meeting went further by strengthening IMF resources. It was also agreed to inject a new general SDR allocation. However, the revision of the conditionality is still not on the agenda.

f. The governance of the International Financial Institutions should be deeply reformed in order to increase their legitimacy and effectiveness. Their heads should be appointed in future through open, merit-based selection processes. IMF quotas should be further revised in order to give more voice to developing and emerging countries.

The G-20 Summit has started to implement this reform, even if at quite a slow pace

g. Development aid must be stepped up to meet the target of 0.7%GDP and transnational schemes for cooperation with developing countries should be urgently implemented by reducing the co-financing of recipient countries. All multilateral development banks should be assured of all the capital they need. New international financing instruments should be developed to pursue the Millennium Development Goals.

The G-20 Summit reasserted commitment to the MDGs and strengthened the resources of the multilateral development banks. The support to low income countries was increased, focusing on social protection, boosting trade and safeguarding development. The World Bank will receive voluntary contributions to an Infrastructure Crisis Facility and a Rapid Response Fund. However, this is still very insufficient to meet the needs of these countries, where this crisis is being combined with a previous one.

h. Credit lines to support trade must be expanded. Protectionist reactions should be prevented by a new momentum to conclude the WTO Doha Round. EU efforts to conclude free trade agreements should also be pursued.

The G-20 Summit has increased the support available for trade credit and reasserted its commitment to achieve an ambitious and balanced conclusion of the Doha Development Round. However several national decisions of the G-20 members contradict this commitment.

i. The G20 should agree on a regular monitoring and assessment of the recovery plans and their international coordination, in connection with the UN and Bretton Woods institutions. Recovery efforts should be based on medium to long term adjustments towards more sustainable consumption and production patterns, sounder financial schemes and a more balanced structure of global demand. The need to push forward with ambitious plans towards a safe and sustainable low-carbon economy should also reinforce efforts for a progressive climate agreement at the UN Copenhagen summit at the end of 2009.

The emergence of the G-20 at leaders level can provide important mechanisms to govern the global economy. Two general frames were adopted in September 2009:

-the Framework for strong, sustainable and balanced growth defined by the G-20, launching a process of mutual assessment of policy frameworks and their implications for the pattern and sustainability of global growth, while trying to identify potential risks to financial stability. The 20 members will agree on shared policy objectives for fiscal, monetary, trade and structural policies to collectively ensure more sustainable and balanced trajectories of growth

- a Charter of core values for sustainable economic activity (macro-economic policies for long term objectives, rejection of protectionism, regulation of the markets for sustainable development, financial markets serving the needs of households, businesses and productive investment, sustainable consumption and production, internationally development goals, need of a new economic and financial architecture

The fundamental crisis is not over. Many developed and developing countries were badly hit. The recovery process will be long. What is at stake is not only to recover but to renew the foundations of our development model. Deep transformational reforms are needed in the financial system, corporate governance, welfare systems, patterns of consumption and production and global governance. Will the G-20 remain a consultation forum or can it become a driving board for economic governance? In this case serious issues of legitimacy and effectiveness should be addressed in connection with the reform of the UN system

The present gap between global problems and global governance is just unacceptable and crucial reforms of global governance can no longer be delayed. More generally, what is at stake is to pave the way for a Global New Deal, reshaping the global order, which should combine a coordinated recovery, a regulation of financial markets, a global agreement to fight against climate change, a multilateral agreement to open markets, stronger development policies and a worldwide extension of the ILO's decent work agenda. Global governance should be reformed to create the conditions for the negotiation and implementation of this Global New Deal.