A Matter of Urgency: A NEW PROGRESSIVE RECOVERY PLAN FOR THE EUROPEAN UNION[1]

The need for a new effort

19 March 2009

Introduction

We are now facing a **crisis of an unprecedented nature**: not only financial, but also economic and social, and not only in some of our Member states, but across the entire European Union and world. European socialist, labour and social democratic governments and political parties must define the way out of this crisis, based on a strengthened European Union rather than a weakened EU.

PES Leaders adopted a joint declaration, on 30th November 2008, calling "For an ambitious recovery plan to safeguard employment and prevent mass unemployment", which states that "the total budgetary stimulus has to be sufficient and coordinated across Europe to have a real, magnified impact on the economy". **Safeguarding jobs and preventing mass unemployment, while promoting smart green growth, represents our number one priority**, guiding all our policy proposals and actions.

Economic forecasts are being consistently revised downwards, showing that the economic recession is deepening and the risk of depression cannot be excluded. The European Recovery Plan adopted by the European Council of 11-12 December 2008 is already outdated and no longer represents an adequate response to the crisis. Several downward spirals are now at work: wage cuts and mass lay-offs are squeezing consumption; the credit crunch is blocking investment; many Member States cannot support demand because of higher spreads in their public debts and some of them because of IMF conditionality. Finally, national protectionist actions can undermine the Single Market and the Economic and Monetary Union

The key problem lies in the insufficient size of the budgetary stimulus across Europe and the failure to coordinate according to a common set of priorities. There has already been evidence that the failure to coordinate has engendered the risk of undermining the Single Market, Economic and Monetary Union and weakening Europe as a global actor. European solidarity and stronger European instruments will be vital to prevent the risks of national protectionism

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

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[1] The PES will regularly update the present discussion paper on a more ambitious and progressive plan, building on our internal exchange of views and on the continued monitoring of conditions in the real economy and actions undertaken at national, European and international levels. This discussion paper will hence serve to inspire further work in the PES and at institutional level.

The real economy and financial markets are linked and must be tackled simultaneously. This should be the essence of all proposals.

This is a systemic and global crisis requiring key reforms in the capitalist system and a new global governance order, necessary for the emergence of a new development model. The crisis should be viewed as a historic opportunity to bring forth transformational change in our economies, leading the way for truly sustainable and socially fair long-term development. We must 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 must 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.

A new, strengthened European Recovery Plan requires:

1. A coordinated and urgent 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:
    - Ensure the proper functioning of the banking system
    - Establish better regulation for all financial players
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.

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1. A coordinated response to the recession

As PES leaders have set out, 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 larger 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.

The internal cohesion of the Single Market should be safeguarded by 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, bringing about a European innovation and industrial policy.

Furthermore, 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;
- 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 European Union and Member States should involve the Social Partners as key stakeholders in the implementation and monitoring of the recovery plan.

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

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 size of the European budgetary stimulus in 2009 and 2010 should be determined by the need to safeguard employment. Therefore current national plans should be strengthened in a coordinated manner, within the framework of a common set of investment priorities. The current outlook for 2009 is deteriorating. According to the latest ECB estimate, European GDP will now go down to -3% this year, taking account of all financial stimuli decided to date as well as the automatic stabilizers. The latest OECD figures (fourth quarter 2008 of minus 1.5%GDP) point to an even worse recession. To illustrate the need for a reinforced, joint recovery investment strategy, we have tested the effects of additional financial stimuli and our analysis confirms that the recommendation of 2%GDP financial stimulus in 2009 and 2%GDP in 2010 is absolutely necessary to bring employment back to 2008 levels in the coming years. Several Member States will not be able to decide on larger stimulus packages without further financial assistance. For this reason, new European financing instruments should be explored to support these countries. 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.

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. 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 between raising or cutting taxes: it is between depression damaging the life chances of many, or investment in a sustainable and prosperous future with real job prospects for all.

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. Member States should be encouraged to reduce social security contributions of wage earners and to increase direct aid to more vulnerable households, as appropriate.

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.

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.

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.

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.

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.

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.

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.

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.

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. The implementation of the EU's climate and energy package is one element of which to take account in the shaping of the programme.

1.2.1. Smarter growth

Even in recession, Europe can create jobs in many sectors: increasing energy efficiency, spreading low carbon technologies, urban renewal, transport, health 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.

For the recovery to bring transformational economic change to the European economy, 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. 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.

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. Leading scientists meeting at the latest International Scientific Conference on Climate Change, in Copenhagen on 10-12 March, have declared that the worst IPCC forecasts are now being realised and that this scenario could in fact prove too optimistic. 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 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.[2] 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:

- Tax credits/government premiums on energy efficiency related household investment (high energy efficient heating systems, building isolation, solar panels). For example, there is enormous potential for solar panels in private homes in Southern Europe. These measures would be very positive for jobs in the building sector - being hit very hard by the crisis now - and in the industries producing these materials.
- Investments in sustainable transport and tax credits/government premiums for cleaner cars;

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

[2] "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.

networks. Meeting the EU's target of 20% renewables in the EU energy mix will depend on investment in interconnection into energy grids, with emphasis on facilitating decentralized production and links to and from regions rich in renewable sources like wind or solar. 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. The European Commission's Strategic Energy Review has already identified key projects including: a Mediterranean energy ring, exploiting the potential of wind and solar power generation in this region; developing the supply and storage of liquefied natural gas and gas; developing a Southern Gas Corridor for gas supply from Caspian and Middle Eastern countries; developing a Baltic interconnection plan; North-South gas and electricity interconnections.

- 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.

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 Initiative and Social Progress Pact should be developed as two major pillars of the recovery plan. The priorities should be:
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a. To launch programmes for job creation in the priorities already identified in.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 massif re-skilling for the 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. 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.

c. 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.

d. 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.

e. To renew social, employment and education policies and services focused on the unemployed. Strengthen unemployment insurance, when needed, and significantly scale up active labour market policies which 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.

f. 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.

g. 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.

h. 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.

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

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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, and closer relationships with customers. This concept should become a driver for the unavoidable restructuring process which should be carried out in the banking sector. I 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 far from being completely implemented and are crucial to re-activate the interaction between the financial system and economic activity, which is at core of this crisis. In spite of the already adopted measures, guaranteeing deposits, ensuring more liquidity and supporting inter-banking lending, 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:

- 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;

- Targeted interventions to support more vulnerable Member States which do not belong to the euro-zone;

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 (now limited to EUR 25 billion) 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.

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.
- Assuming the European Central Bank should strengthen its supervisory role regarding macroeconomic stability, a European financial regulatory agency should be created for the eurozone in order to supervise micro-economic stability, safeguard competition and consumer protection.
- A College of Supervisors should be organized as an independent authority with clear competences at European level.
- 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.

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3. International cooperation for a global response to the crisis and sustainable development

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. Again, restarting banking activities, regulating the financial system, coordinated fiscal stimulus, supporting developing countries and promoting the necessary structural adjustments should be the key priorities:

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.

b. Restoring bank lending to business and people according to a common framework ensuring clear conditionality for public support.

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.

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.

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);

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;

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.

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.

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.

More generally, this discussion should 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.

18 March 2009

ANNEX: A Scenario for a new European recovery action[3]

The European Council agreed on 12-13 December on a European recovery plan of around 1.5% of EU GDP or 200 billion euros, within both national budgets (around €170 billion, 1.2% of GDP) and EU and European Investment Bank budgets (around €30 billion, 0.3% of GDP). The present economic scenario shows the net impact on growth, employment and public finances if EU Member States were to go further than the European Council's agreed budgetary stimulus.

Present Forecast

Table 1: Estimating the size of the stimulus package for 2009[4]

	€ bn	%GDP
Belgium	1.2	0.3%
Denmark	0.0	0.0%
Germany	35.8	1.4%
Ireland	0.0	0.0%
Greece	0.0	0.0%
Spain	12.3	1.1%
France	16.9	0.8%
Italy	-0.3	0.0%
Netherlands	3.2	0.5%
Austria	3.9	1.3%
Poland	1.5	0.5%
Sweden	1.1	0.4%
United Kingdom	16.5	1.0%
13 Largest EU countries	92.3	0.8%
Imputed EU-27 total	106.0	0.8%
European Commission	9.3	0.07%
Imputed Grand Total	115.0	0.87%

As seen in table 1, the total effect of the 13 EU countries' financial stimulus, including the impulse at EU level, is no more than 0.9% GDP. This represents the real demand effects in the economy. That is just over half of what was decided in the European Recovery Plan at the December 2008 European Council.

Table 2 below shows the present official economic forecast according to the European Commission in January 2009. In table 2 it is assumed that the automatic stabilisers are at work and that the packages adopted until mid January are implemented (0.9% GDP). In the baseline scenario in table 2 the EU-27 will go into deep recession in 2009, unemployment will increase by nearly 2.5% over the next two years and public finances will worsen.

[3] Data by FEPS and the Economic Council of the Labour Movement, Denmark, unless otherwise stated.

[4] "Estimating the size of the European stimulus packages for 2009: An Update", David Saha and Jakob von Weizsäcker, 20 February 2009, Bruegel.

Table 2. **Present** forecast for the EU-27 economy (from the European Commission, Jan 09)

	2008	2009	2010	2011	2012
GDP growth (%)	0.8	-2.1	0.4	1.7	1.8
Employment (million)	220.6	216.4	215.3	216.0	217.0
Unemployment rate (% of labour force)	7.1	8.8	9.4	9.4	9.3
Government balance (% of GDP)	-2.0	-4.6	-5.0	-4.7	-4.6

Source: Calculation by ECLM based on the international model "HEIMDAL".

It is also clear from table 2, that the budgetary stimulus packages adopted to date are not enough to prevent a severe economic crisis.

Since the forecast in table 2, the current outlook in 2009 has deteriorated according to estimates by the ECB and statistics from the OECD.

Unfortunately, the scenario presented below in table 3 is now, as things appear at the moment (March 2009), the most likely scenario for the future.

If the EU-27 experiences negative GDP growth of more than -3%GDP in 2009, the unemployment rate will rise to as much as 10% already in 2010, as shown in Table 3. In the calculations it is assumed that consumer and investor confidence will drop even lower than assumed in table 2 and that the EU-27 economy as a consequence will be hit even harder than first assumed. Just as in the present forecast of table 2, table 3 includes financial stimuli (cf. Table 1) and automatic stabilisers.

Table 3. Latest estimate for the EU-27 economy (March 2009)

	2008	2009	2010	2011	2012
GDP growth (%)	0.8	-3.1	0.1	1.7	1.9
Employment (million)	220.6	215.4	213.3	214.0	214.9
Unemployment rate (% of labour force)	7.1	9.1	10.0	10.0	9.9
Government balance (% of GDP)	-2.0	-5.0	-5.7	-5.3	-5.1

Source: Calculation by ECLM based on the international model "HEIMDAL".

Unless we make a new recovery effort in Europe, unemployment will increase to 25 million people by early 2010 coupled with much deteriorated public finances.

Therefore additional stimuli are needed. There is an urgent need to increase investments in the European Union in order to safeguard employment and prevent mass unemployment.

Scenario for a new coordinated investment effort

To illustrate the need, the effects of a very modest extra budgetary stimulus are shown below.

It is now assumed that the each country will stimulate the economy up to 1.5% GDP in 2009 and extra 1.5% GDP in 2010 with the already adopted stimuli taken into account. Table 4 illustrates the effects on the EU-27 economy. As shown below the stimulus will in this case be nowhere near adequate to prevent a severe growth crisis and the stimulus is **far from enough** to ensure that employment returns to its 2008 level within a shorter time period.

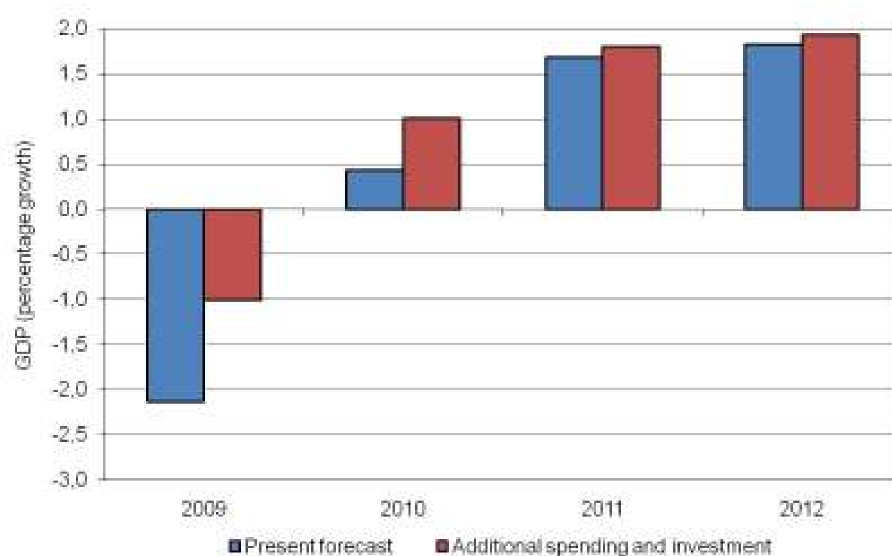
Table 4. Latest EU-27 estimate (March 2009) with additional budgetary stimuli

	2008	2009	2010	2011	2012
GDP growth (%)	0.8	-1.9	0.7	1.8	2.0
Employment (million)	220.6	216.6	215.9	216.9	218.1
Unemployment rate (% of labour force)	7.1	8.8	9.3	9.1	8.9
Government balance (% of GDP)	-2.0	-5.3	-6.0	-4.6	-4.4

Source: Calculation by ECLM based on the international model "HEIMDAL".

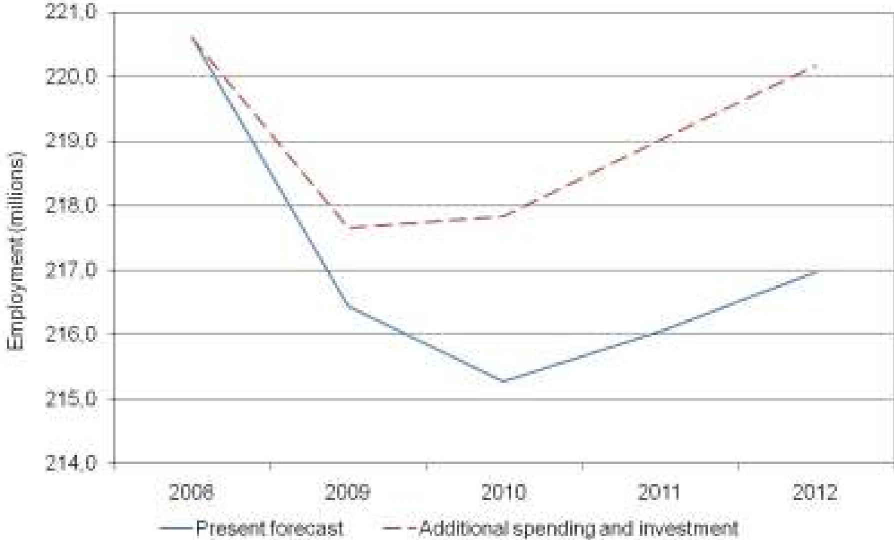
Figures 1-4 show a graphical presentation of the effect of the new scenario.

Figure 1. Development in EU-27 GDP growth, 2009-2012.



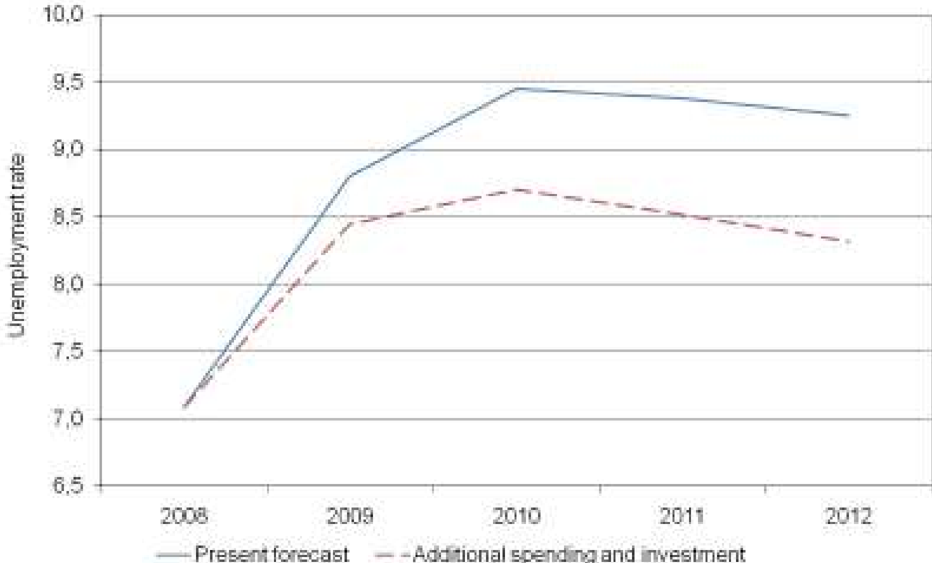
Source: Calculation by ECLM based on the international model "HEIMDAL".

Figure 2. Development in employment in EU-27 (millions), 2008-2012.



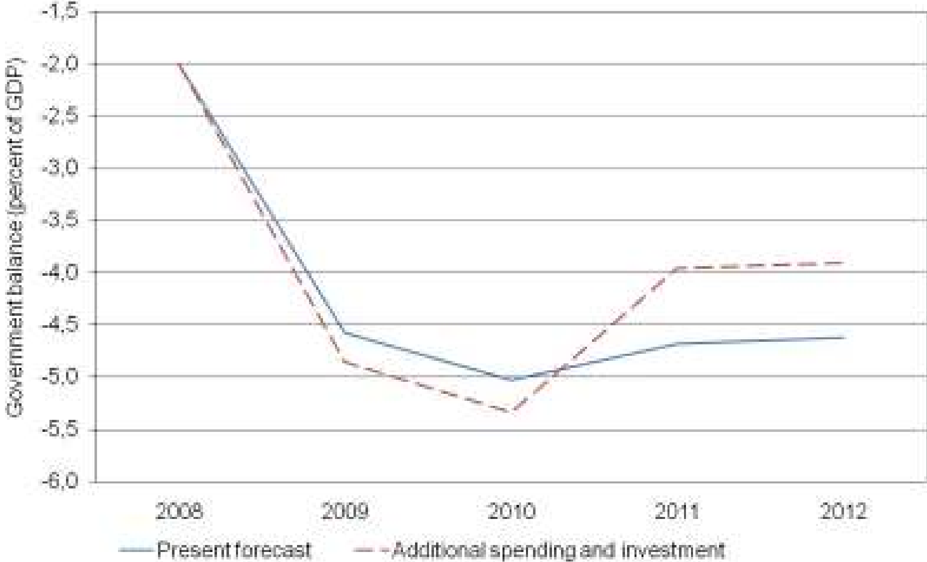
Source: Calculation by ECLM based on the international model "HEIMDAL".

Figure 3. Development in the EU-27 unemployment rate, 2008-2012.



Source: Calculation by ECLM based on the international model "HEIMDAL".

Figure 4. Effect on the public budget in EU-27 (percent of GDP), 2007-2012.



Source: Calculation by ECLM based on the international model "HEIMDAL".