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COMMUNICATION FOR THE SPRING EUROPEAN COUNCIL

Driving European recovery

VOLUME 1

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1. INTRODUCTION

The past six months have seen unprecedented pressure in Europe from a global economic crisis. The EU's reaction has been a test of resilience and of our speed of reaction. This situation has also presented challenges of co-ordination and reinforced the need for solidarity among the 27 Member States. Last autumn, the EU took the action needed to prevent a meltdown in financial markets. In December, it agreed to put in place a European Economic Recovery Plan (EERP) to arrest the pace of the downturn and create the conditions for an upturn. The Commission and Member States have responded positively to the need to take measures to deal with the crisis and prepare for recovery.

Now that they are being implemented, the need for greater co-ordination in order to maximise the positive cross border impacts of these measures is beginning to be felt. The purpose of this Communication is to set out the next steps in dealing with the crisis and leading the EU to recovery. It contains an ambitious programme of financial sector reform, reviews the measures being taken to sustain demand, boost investment and retain or create jobs and sets out a process for preparing the Employment Summit in May. It also places the EU's internal efforts in the wider context of the upcoming G20 Summit, where the EU should present an ambitious agenda for reforming the international financial governance system.

As the global economy has continued to slide, falling demand and lost jobs are hitting businesses, families and communities throughout the EU. Confidence in the financial sector remains frail. New weaknesses are coming to light and require a co-ordinated response. Cleaning up the banking system is a prerequisite for a return to normal credit conditions. A major mobilisation of efforts is necessary, because recovery will take time.

The stabilisation of the financial markets has not yet fed through to loosen the credit crunch and get lending flowing again to companies and households. It is also why the EU must keep up the pace of financial sector reform, implementing reforms to regulation, and looking ahead to a supervisory regime more in tune with today's cross-border realities.

As long as lending remains scarce, efforts to boost demand and consumer confidence will be held back. Since the Recovery Plan was adopted in December, implementation of the agreed stimulus package has begun. Although it will take time for the positive effects to work their way through the economic system, the size of the fiscal effort (around 3.3% of EU GDP or over €400 billion) will generate new investment, support workers and their families and boost demand. Action is also coming on stream which targets efforts on the long-term objective of building a competitive and sustainable EU economy, as set out in the Lisbon strategy for growth and jobs. This ensures that the EU not only tackles the immediate downturn, but prepares to make the most of future opportunities.

At the same time, the impact on jobs has spread. Targeted action is needed to limit the hardship for individuals and prevent the loss of precious skills. Steps can and should be taken to keep people in employment through the downturn and to use creative solutions to maintain the goal of developing a more highly-skilled workforce.

This is a global crisis, and recovery will not be complete until the major players of the world economy are once again growing and trading together. The steps taken in the EU have served as inspiration for global partners, and have helped to build a consensus for action which should be reflected in concrete action at the forthcoming G20 meeting in London.

As the crisis has unfolded, the importance of the EU dimension has become increasingly clear. The single market has provided the bedrock of EU economic growth for the past 15 years, a driver of growth that has created millions of jobs, making Europe more competitive and more efficient. It has shaped an unprecedented interdependence which means that traders, suppliers, manufacturers and consumers are linked as never before. All Member States trade more with each other than with the rest of the world. Therefore, the best way to boost the economy is to work with the grain of this interdependence, avoiding any attempt to put artificial constraints on the impact of recovery measures.

This puts the spotlight on the importance of coordination. While recognising that there are clear differences in the social and economic situations of Member States, each has a wide range of levers at their disposal to address their particular circumstances. These levers will be most effective if they are used within a clear EU framework. For example, national actions to boost demand will often have a positive cross border effect on goods and services in other Member States and thus feed through into a virtuous circle of recovery for Europe as a whole.

The EU economy has huge long-term strengths. By maintaining its strong position in world export markets, it has shown that it has the competitiveness to succeed in the age of globalisation. It has a highly skilled workforce and social models that are proving their worth at a time of extreme pressure, protecting the most vulnerable in our society. The EU is particularly well placed to make the transformation to a low-carbon economy and take up the technological challenge of tackling climate change. Tackling the challenge of the crisis together in a spirit of solidarity is the best way for Europe to exploit these strengths to arrest the downturn and return to growth.

2. RESTORING AND MAINTAINING A STABLE AND RELIABLE FINANCIAL SYSTEM

2.1. Rebuilding confidence and lending

A stable financial sector is a prerequisite for building sustainable recovery. Last autumn, coordinated European action to recapitalise and guarantee banks across the EU prevented the meltdown of the European banking industry and helped restore some liquidity in interbank markets.

Now it is time to move to monitoring these financial sector support packages to ensure that they are effectively implemented. Both home and host country authorities of cross-border financial institutions have a strong mutual interest in preserving macro-financial stability by guaranteeing the funding and stability of local banking systems and adhering to the principle of free movement of capital.

The Commission has already presented legislative proposals to improve protection for bank depositors, make credit ratings more reliable, get the incentives right in securitisation markets, and reinforce the solidity and supervision of banks and insurance companies. Adjustments to the accounting rules were rapidly agreed to put European financial institutions on a level playing field with their international competitors. These measures are part of building a stronger, more reliable system for the future.

But confidence in the banking industry remains low. Banks and other financial players are still in process of deleveraging and have not resumed their usual roles in either wholesale or retail markets. They are maintaining a very restrictive approach to lending. Restoring the flow of credit to the real economy is therefore a key priority, to prevent a further reduction in economic growth.

It is time for action to break the cycle of declining confidence and unwillingness to lend. In some cases, this means dealing directly with the asset side of banks' balance sheets, putting an end to uncertainty about the valuation and location of future losses. To restore confidence in the banking sector as a whole, banks with impaired assets should disclose them to the competent authorities.

Building on the guidance already given on the application of state aid rules to measures to support and recapitalise financial institutions[1], the Commission has presented a Communication[2] to help Member States design measures for dealing with impaired assets. Options include state purchase, state guarantees, swapping or a hybrid arrangement. It is for Member States to decide whether to use these tools and how they are designed. But a common and coordinated European framework, based on the principles of transparency, disclosure, valuation and burden-sharing, will help ensure asset relief measures have the maximum effect.

The framework will ensure a level playing field between banks, facilitate compliance with the state aid rules and limit the impact on public finances and prepare for the necessary restructuring of the sector. The Commission will shortly provide more detailed guidance on its approach to the assessment of restructuring and viability plans of individual banks under the state aid rules. It will make a case-by-case assessment, taking into account the total aid received through recapitalisation, guarantees or asset relief, to ensure long-term viability and a return to normal functioning of the European banking sector.

To improve credit conditions, the ECB and other central banks have been providing considerable liquidity. They have already cut interest rates and the ECB has flagged that there could be scope for further reductions. By creating demand for loans, the impact of the fiscal stimulus can also be expected to increase bank confidence and willingness to lend. Credit flows should therefore be monitored very closely in the coming months to ensure that extensive public intervention in the financial sector really does result in relief for European households and businesses.

2.2. Responsible and reliable financial markets for the future

The crisis has exposed unacceptable risks in the current governance of international and European financial markets which have proved real and systemic in times of serious turbulence. The unprecedented measures being taken to restore stability in the sector must be matched by robust reform to remedy known weaknesses, identify and prevent the emergence of new vulnerabilities in the future. European businesses and citizens need to be able to trust financial institutions as reliable partners for translating their deposits into the investment that

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1 OJ C 270, 25.10.2008, p. 8, and OJ C 10, 15.1.2009, p. 2.
2 C(2009) 1345 (not yet published).

is so central to the long-term health of the economy. Market surveillance and enforcement of contractual and commercial practices will play an important role in restoring consumer confidence in retail banking.

Over the course of 2009, the Commission will propose the ambitious reform of the European financial system which is set out below and in more detail in Annex I. The reform will set a clear course for the EU to lead and shape the process of global change in particular through the work of the G-20. In parallel, the Commission will continue to apply the framework for urgent rescue relief as well as long-term restoration of viability in application of the existing state aid guidance.

The reform will ensure that all relevant actors and all types of financial instrument are subject to appropriate regulation and oversight. It is grounded in the values of responsibility, integrity, transparency and consistency.

Last year in November, the Commission mandated a High Level Group chaired by Mr Jacques de Larosière to propose recommendations for this reform, with a particular focus on supervision. The Commission welcomes the report presented on 25 February 2009 and shares the Group's analysis of the causes of the financial crisis. The Group's 31 recommendations offer a comprehensive set of concrete solutions for regulatory, supervisory and global repair action.

Many of the Group's recommendations for regulatory repair contribute to a growing consensus about where changes are needed, reflecting issues raised by key actors including the European Parliament. The Commission has already taken concrete initiatives in areas such as credit rating agencies; insurance; revision of capital requirements under Basel II; securitised products; mark-to-market accounting rules and addressing pro-cyclicality of regulatory measures. Industry has acceded to the Commission's request to move Credit Default Swaps on European entities and on indices of European entities onto a central clearing platform established, regulated and supervised in Europe by 31 July 2009. In other areas, such as the regulation of hedge funds and other non-bank investment actors, transparency of derivatives markets and improved accounting rules, Commission proposals will be brought forward as a matter of priority in the coming months.

The Group's recommendation on the need to develop a harmonised core set of standards to be applied throughout the EU is of particular interest. Key differences in national legislation stemming from exceptions, derogations, additions made at national level or ambiguities in current directives should be identified and removed. The Commission will therefore launch an important new initiative in this sense. The Group's findings on sanctions regime also point to the need for a new push on this front.

In the supervisory sphere, nationally-based supervision models are lagging behind the market reality of more and more banks and insurance companies operating across borders. The Commission has already proposed establishing colleges of supervisors to facilitate cooperation between supervisors for cross-border bank and insurance firms. Coordination within the three Committees of European Supervisors has been a significant step forward but is not without limitations. The Commission has modified the Committees' mandates which will improve their efficiency and effectiveness, introduce qualified majority decision-making and a "comply or explain" approach. A proposal to give the Committees better funding for their activities is currently before the budgetary authority.

The de Larosière Group's report highlights the existing gaps in preventing, managing and resolving crises and the difficulties caused by a lack of cooperation, coordination, consistency and trust between national supervisors. For businesses, complying with numerous different regimes brings additional administrative and regulatory burdens. The Commission agrees with the Group's finding that recent experience has exposed important failures both in the way supervisors look at particular cases, and in their approach to the financial system as a whole.

Regarding macro-prudential supervision, the Commission particularly welcomes the Group's idea for a new European body, under the auspices of the ECB and involving the Commission and the Committees of European Supervisors, to gather and assess information on all risks to the sector as a whole, across all sectors of finance. Such a body would be well placed to identify systemic risks at European level and issue risk warnings. Mandatory follow-up and monitoring tools, and the possibility to refer issues to global early warning mechanisms, would be essential.

In terms of supervising individual companies, the Group has recommended the establishment of a European System of Financial Supervision (ESFS). In a first phase the three Committees of European Supervisors as well as national supervisors would be strengthened, and a more harmonised set of supervisory powers and sanctioning regimes would be introduced. In a second phase, the Committees would be transformed into Authorities carrying out certain tasks at European level, whilst relying on colleges of supervisors and national supervisors for the day-to-day supervision of individual companies. A review after three years would consider the need for further consolidation of the ESFS.

The Commission agrees with the Group's finding that the structure of the existing Committees – whose role has reached the limits of what is legally possible - is not sufficient to ensure financial stability in the EU and its Member States, and that the inefficiencies in the present structure need to be resolved as swiftly as possible. The Commission also considers that there are merits in a system which combines certain centralised responsibilities at European level with maintaining a clear role for national supervisors who are closest to the day-to-day operation of companies.

The Commission considers that action is urgently needed and will propose to accelerate the implementation of the Group's findings. By combining the two phases proposed by the Group, it should be possible to move more quickly to both improve the quality and coherence of supervision in Europe, and to transform the three existing Committees into authorities within a European financial supervision system. The feasibility of whether to combine one or more of these authorities should be examined with a view to ensuring maximum supervisory coherence and enhancing consistency and interaction between banking, insurance and markets supervisory experts.

The authorities could be charged with oversight and ultimate decision-making powers regarding colleges of supervisors for cross-border groups; ensuring consistency and good practice through setting common high standards and providing common interpretations of requirements for supervisory activities; and a key role in early warning mechanisms and crisis management, working with the body set up to look at the overall picture.

Building on the recommendations of the de Larosière Group, the Commission will now move forward in developing proposals to establish a new European financial supervision system. Drawing on views expressed by Member States, the existing Committees, the European Parliament, the ECB and other stakeholders, the Commission will prepare its proposals on the basis of an impact assessment, in line with its better regulation principles.

To deliver responsible and reliable financial markets for the future, the Commission will propose an ambitious new reform programme, with five key objectives:

(1) To provide the EU with a **supervisory framework** that detects potential risks early, deals with them effectively before they have an impact, and meets the challenge of complex international financial markets. The Commission will present a **European financial supervision package** before the end of May 2009, for decision at the June European Council. The legislative changes to give effect to these proposals will follow in the autumn and should be adopted in time for the renewed supervisory arrangements to be up and running in the course of 2010. The package will include two elements:

– Regarding macro-prudential supervision, measures to establish a **European body** to oversee the stability of the **financial system as a whole**

– Regarding micro-prudential supervision, proposals on the architecture of a **European financial supervision system**

(2) To fill gaps where European or national **regulation** is insufficient or incomplete, based on a 'safety first' approach. The Commission will propose:

– A comprehensive legislative instrument establishing regulatory and supervisory standards for **hedge funds, private equity** and other systemically important market players(April 2009)

– A White Paper on **tools for early intervention** to prevent a crisis (June 2009)

– On the basis of a report on **derivatives** and other complex structured products (June 2009), appropriate initiatives to increase transparency and ensure financial stability

– Legislative proposals to increase the quality and quantity of **prudential capital** for trading book activities and tackle complex securitisation (June 2009) and to address liquidity risk and excessive leverage (Autumn 2009)

– A rolling programme of actions to establish a far **more consistent set of supervisory rules** (to be launched in 2009)

(3) To ensure that European **investors, consumers and SMEs can be confident** about their savings, access to credit and their rights as concerns financial products, the Commission will come forward with:

– A Communication on **retail investment products** to strengthen the effectiveness of marketing safeguards (April 2009)

– Further measures to reinforce **bank depositor, investor and insurance policy holder protection** (Autumn 2009)

– Measures on **responsible lending** and borrowing (Autumn 2009)

(4) To **improve risk management** in financial firms and align **pay incentives** with sustainable performance. To this end, the Commission will:

– Strengthen its 2004 Recommendation on **remuneration of directors** (April 2009)

– Bring forward a new Recommendation on **remuneration in the financial services sector** (April 2009) followed by legislative proposals to include remuneration schemes within the scope of prudential oversight (Autumn 2009)

(5) To ensure **more effective sanctions** against market wrongdoing. To this end, the Commission intends to:

– Review the **Market Abuse Directive** (Autumn 2009)

– Make proposals on how **sanctions** could be strengthened in a harmonised manner and better enforced (Autumn 2009)

The Commission invites the Spring European Council to endorse this reform ahead of the G-20 London Summit. This will demonstrate the European Union's willingness and commitment to take ambitious measures to implement the G-20 Washington action plan. The European Parliament and the Council should be invited to give due priority to the Commission's forthcoming proposals.

3. SUPPORTING THE REAL ECONOMY

The global economy is in the midst of the worst recession in decades. World trade has contracted at a rapid pace. Industrial production declined rapidly towards the end of 2008. Both the US and Japan have seen a marked decline in GDP, whilst China had its lowest growth performance since 2001 reflecting the dramatic decline in world trade.

The EU economy could not escape this worldwide downturn. Both the euro area and the EU are now in a serious recession. Output in manufacturing and construction has been especially hard-hit with an estimated loss of € 150 billion in full-year terms. The automotive sector alone fell by 32.3%, which triggered deterioration in many other sectors. EU manufacturing exports to non-EU countries dropped by 5.8% in November/ December 2008, while intra-EU trade was 13.7% lower than the previous year.

But whilst real GDP is expected to fall by nearly 2% in 2009[3], it should recover gradually to around ½% in 2010 in part due to the effects of policy measures being taken at European and national level under the European Economic Recovery Plan (EERP).

3.1. Implementing the European Economic Recovery plan

In December 2008, on the basis of proposals from the Commission, an ambitious European Economic Recovery Plan (EERP) was agreed. At its core was a combined effort to give Europe's economy an immediate fiscal boost, while targeting this investment at strengthening the European economy for the long-term challenges ahead. It recognised that the fall in private demand made the role of public expenditure even more important in the short term.

The full impact of the EERP will only become clear in the coming months, but the early signs are positive, both in terms of volume of the stimulus and the direction of reforms. Most

[3] According to the Commission's January forecast.

Member States have now adopted or announced fiscal stimulus measures. Over the period 2009 and 2010, fiscal policy is providing support to the economy in the region of 3.3% of GDP, equivalent to more than € 400 billion, a potentially huge support to growth and jobs across the EU.

A large share of this support comes from the operation of automatic stabilisers which are particularly strong in the EU. It also comes from discretionary fiscal stimulus packages of Member States in the region of 1.2% of GDP called for in the EERP, although the scale varies widely according to the Member States' room for fiscal manoeuvre. A further € 30 billion or 0.3% of GDP has been made available from EU sources[4]. The Commission has proposed a targeted investment to the tune of € 5 billion to address the challenge of energy security and to bring high-speed internet to rural communities, as well as through additional advance payments under cohesion policy amounting to € 11 billion, of which € 7 billion for new Member States. Moreover, the European Investment Bank (EIB) has boosted its SME lending possibilities by € 15 billion.

Most of the measures Member States are taking are well targeted to stimulate demand: support for households, business, and employment, directly increasing demand through public investment and the modernisation of infrastructure (see Annex II for details). And most of these measures are consistent with the longer-term objectives identified in the country-specific recommendations under the Lisbon strategy for growth and jobs – such as building Europe's knowledge base, boosting energy security and adapting to a low-carbon economy.

An effective and rapid implementation of these measures will be critical, and will need to be complemented by action to improve business conditions. The EU has every interest in maintaining a strong and competitive industrial base as it moves towards a knowledge-based and low carbon economy. Given the complex nature of modern industrial production, the economies of scale and opportunities for diversification offered by the Single Market, the EU has developed a policy of horizontal support for industry in recent years. At both EU and national level this means that R&D, innovation, new and environmental technologies as well as training can all be funded as support and development measures. These horizontal measures can be implemented in different sectors of the EU economy, as recently illustrated in the EU framework for the automotive industry, issued by the Commission on 25 February[5].

Member States are also giving priority to the needs of SMEs due to their huge contribution to overall employment in the EU and are invited to speed up implementation of the Small Business Act. The Commission will shortly table a legislative proposal to tackle the issue of late payments more effectively. Moreover, the potential of better regulation should be used to the full, notably via the reduction of administrative burdens.

Action to raise skills, to boost investment in research, to promote the conditions for innovation, to spread high-speed Internet, to renew existing transport and energy infrastructure, including through increased use of public private partnerships, to upgrade energy efficiency and to increase renewable energy all fit squarely into the objectives of the EERP. Such action will be facilitated by rapid adoption of the proposed modification of cohesion policy legislation. Member States are encouraged to make full use of the possibilities offered by these modifications to speed up key investments.

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4 Including a number of new public private partnerships.

5 COM(2009) 104, 25.2.2009.

Understanding and managing the long-term impact of the crisis on public finances - and managing the consequences for pension and healthcare systems - will be vital. Budget deficits should return to positions consistent with the need to ensure long-term sustainability of public finances as soon as economic conditions allow, notably in view of the future cost stemming from an aging population. Long-term sustainability should be ensured within the framework of the Stability and Growth Pact.

Some Member States are now in a process of reducing their budget deficit to reduce their dependence on external flows of credit. The support facility for medium term assistance to the balance of payments of non euro area Member States has been strengthened following timely support to Hungary and Latvia.

The EERP is part of the Lisbon Strategy for Growth and Jobs in the current crisis. It provides the right balance to combine an immediate stimulus with the long-term perspective needed. As a result, Europe should come out of the crisis better prepared to meet the challenges of a world economy geared towards low-carbon and innovative activities.

The Commission will closely monitor the impact of the measures taken, together with the Member States, and report on progress made ahead of the June European Council.

3.2. The Single Market as a lever for recovery

Europe's successful economic recovery will depend on our ability to make the most of both internal and global markets. The Single Market has been the motor of economic and social prosperity and job creation in the EU[6]. It offers economies of scale, efficiency gains, and the chance to harness the EU's strengths. It can act as one of the key drivers for recovery provided it is closely coordinated at European level.

Helping to coordinate the response to the crisis, the Commission has ensured that in designing demand support measures, Member States can take full advantage of the flexibility available under existing Community rules. The use of the accelerated public procurement procedure means public investment contracts can be signed within one month. The temporary framework for state aid measures helps companies to access finance in the face of restrictive bank lending. Member States can provide additional export credit insurance through public entities where such insurance is no longer available from the private sector owing to the financial crisis.

At the same time, the EU needs to continue its own work to improving the business environment, to support the small and medium sized enterprises likely to lead the way when recovery comes. The Commission has recently presented proposals to reduce accounting burdens on microenterprises, with potential savings for business of around € 6 billion[7], and will continue to carefully weigh the burden of new initiatives. The timely transposition of the Services Directive this year will present a further means to promote new economic activity and employment opportunities.

Upholding the benefits of the Single Market, and promoting the same values outside Europe, will give the EU a unique launch pad for the return to growth. Protectionism and a retreat

[6] The Internal Market has raised EU prosperity by 2.15% of EU GDP year on year and added 2.75 million extra jobs between 1992 and 2006. Intra-EU trade relative to GDP rose by 30% between 1995 and 2005.

[7] COM(2009) 83, 26.2.2009.

towards national markets can only lead to stagnation, a deeper and longer recession, and lost prosperity.

Member States' action to address the crisis must take the Single Market dimension into account. Most, if not all, Member States will intervene to support economic activity on their territory during this crisis. The intelligent use of national levers in a European context is the best way to ensure that action will be effective.

National measures can be most effective if Member States act in the knowledge that they are working with the grain of the single market. Working in partnership with Member States, the Commission stands ready to provide assistance with the design and implementation of concrete measures, promoting the exchange of good practices and sharing policy experience. This coordination can ensure that positive spill-overs are maximised. It should include sharing information on measures taken as well as joint assessments of the impact of these measures. Annex III provides further guidance on how Member States can design recovery measures in order to ensure their compatibility with the most relevant Community legislation.

3.3. Renewing the European economy beyond the crisis

There is no doubt about the real pain that this twofold crisis – financial and economic – is causing to European households and businesses. The road to recovery will be gradual and will require a major mobilisation of efforts by all involved to accelerate implementation of structural reforms under the Lisbon Strategy. By pooling our efforts and by making the most of our competitive advantages, especially our Single Market, we can ensure that Europe comes out of this recession more quickly.

By keeping our sights firmly on our shared principles and our longer term policy goals, the measures we are taking to get through the present crisis will prepare the ground for a smooth transition to the European economy of the future. In particular, we should maintain the pace of our efforts to shift to a low carbon economy: when the upturn starts green technologies and products should be the lead markets. We need to launch work now on how to improve the structures we have to deal with the recovery: companies will restructure, some will diversify and some may leave the market. The process of returning nationalised companies to private ownership and generally returning the level of state intervention in our economies to more normal levels will need careful management. Community competition policy can support this vital process, steering it towards open, efficient and innovative outcomes.

The lessons of the crisis will also need to be taken into account in renewing the European structural reform agenda. Drawing on the lessons of recent experience, the Commission intends to launch a debate on the Integrated Guidelines for Growth and Jobs under the Lisbon Strategy, which guide the Member States and the Community in the preparation of their respective programmes for structural reform.

The Commission will work closely with Member States and other Lisbon strategy stakeholders to take account of the outcome of this debate in the design of the post-2010 Lisbon Strategy. This process will start with a general review of the revised Lisbon Strategy under the Swedish Presidency in preparation of decisions to be taken in the spring of 2010 under the Spanish Presidency.

The full impact of the EERP will only become clear in the coming months, but the early signs are positive both in terms of the volume of the stimulus and the direction of reforms:

– Most Member States have now adopted or announced fiscal stimulus packages, meeting the overall target of 1.5% of the Union's GDP. Taking into account the effects of the automatic stabilisers, fiscal support of some 3.3% of GDP has been made available for the recovery. This amounts to more than € 400 billion, a huge stimulus to growth and jobs.

– Most of the Member States' measures are targeted to stimulate demand and consistent with longer-term objectives such as raising skills, enhancing investments in innovation, promoting high-speed internet, renewing existing transport and energy infrastructure.

– The Commission has ensured that in designing demand support measures Member States can take full advantage of the flexibility available under Community rules. For instance, The Commission has recently presented guidance on measures for the automotive industry to help Member States as they provide support for the restructuring of this sector.

Through the Single Market all Member States will benefit directly and indirectly from orders for goods and services placed as result of this stimulus package. Member States should pay particular attention to maximising the positive spill-over effects from the Single Market, which has been and will remain the motor of economic and social prosperity and job creation in the EU.

To this end, the following **principles** should shape Member States' actions to support the real economy:

– Maintaining **openness** within the internal market, continuing to remove barriers and avoid creating new ones.

– Ensuring **non-discrimination** by treating goods and services from other Member States in accordance with EU rules and Treaty principles.

– Targeting interventions towards our **longer term policy goals**: facilitating structural change, enhancing competitiveness in the long term and addressing key challenges such as building a low carbon economy.

– Taking full account of the crucial importance of SMEs by applying the "think small first" principle.

– Sharing information and best practice to **maximise the overall positive impact** through effects of scale.

– Pooling efforts and designing measures so that they generate **synergies** with those taken by other member states. Stronger co-operation at European level is key in this respect.

– Using the flexibility provided by the renewed Stability and Growth Pact responsibly, allowing for **return of government deficits to positions consistent with sustainable public finances** as soon as possible, whilst vigorously tackling the causes behind macro-economic imbalances.

– Keeping the Single Market **open to our trade partners** and respect international commitments, in particular those made in the WTO.

In line with the EERP, Member States must now ensure that the fiscal stimulus packages are accompanied by an acceleration of structural reforms in the areas highlighted in the Lisbon strategy country-specific recommendations. It is the best way to ensure that expenditure now will be most cost-effective, raising future potential growth and least damaging to the long-term fiscal outlook for the future. It is an essential prerequisite for Europe also to seize the opportunities offered by this crisis and come out best prepared for meeting the challenges of a new world economy, geared towards low-carbon, innovation, ICT and skills.

The Commission will monitor progress regularly and report in due time for the next European Council meetings. Taking into account the results of the EERP, the Commission also intends to start preparing the post 2010 Lisbon Strategy.

4. SUPPORTING PEOPLE THROUGH THE CRISIS

The impact of the slowdown on households and workers is now mounting. Having performed well in recent years, the labour market situation is now deteriorating rapidly and significantly. The Commission forecasts that employment growth will be negative for the next two years. Unemployment is expected to rise steeply. Although the picture varies across Member States, overall employment is expected to contract by 1.6% this year - some 3.5 million jobs – and unemployment in the EU could reach 10% in 2010.

Some adjustments on the labour market reflect the impact of successful past structural reforms. While this should facilitate a quicker improvement when the economy rebounds, it remains clear that the short-term pain will be high. Young people, those with short-term contracts, and migrant workers are likely to be the worst hit.

4.1. Alleviating the human cost of the crisis

Most Member States have introduced employment and social measures in order to support people and alleviate the human cost of the crisis. Whilst Member States are in the forefront of tackling these challenges, European policies add value by helping them design and implement effective responses to the jobs and social cohesion challenge.

Member States have focused their measures on four broad types of priorities:

– Measures aiming at **maintaining existing jobs:** short-time working allowances, reduced social security contributions, wage subsidies and support to SMEs;

– Measures to **ensure rapid (re-) integration into the labour market:** vocational training and support for the disadvantaged, changes in sickness or disability benefits, and new eligibility rules for unemployment benefits;

– Measures to **support the most vulnerable:** increase in minimum income/wage, extended coverage or duration of unemployment benefits, higher housing or family allowances, tax rebates or exemptions, and measures against over-indebtedness or repossession;

– Measures to **strengthen social protection and invest in social and health infrastructure:** investments in housing, hospitals, primary care, long-term care infrastructure and schools, and actions to help pension funds meet their long term liabilities.

The employment and social impact of the crisis is still unfolding, and it is more severe than expected when most initial measures were put in place. Therefore, efforts need to be stepped up at all levels in order to tackle unemployment, and to adapt and modernise social assistance, healthcare and public health schemes. Income support combined with active measures will stimulate demand, facilitate the transition back to work and avoid social exclusion.

To support Member States in their efforts to address the crisis and implement the recovery measures, the available financial instruments are being strengthened. Renewing the **European Globalisation Adjustment Fund**[8] will allow it to be quickly activated to support workers hit by significant job cuts and their communities.

The current **European Social Fund (ESF)** programmes support 9 million workers each year; € 10.8 billion in grants are available through the ESF in 2009 alone. The Fund can respond to crisis-driven needs, e.g. to improve matching of labour demand and supply, support joint initiatives by social partners, promote social innovation and employment partnerships, or strengthen public employment services. The simplification of the rules for the ESF[9] will allow an immediate increase of advance payments of € 1.8 billion. In all cases where there is a need to adapt the ESF programming to the needs of the crisis, the Commission will ensure that programme changes are completed in the shortest possible time.

While further measures to support employment have to be tailored by Member States, in cooperation with the Social Partners, to their specific economic conditions and labour market situation, it is important that they remain consistent with long-term structural reform needs. Measures should facilitate the long-term restructuring process of the most affected sectors, enhance their competitiveness and human capital. They should also help to address key long-term challenges such as the impact of demographic ageing on labour supply and to seize the opportunities of the low-carbon economy.

In order to maximize positive spill-over effects, and to better address collectively the unprecedented challenges of the crisis, the Commission will promote mutual learning and exchange of good practices across the Member States.

The following **elements** can help Member States in the design of appropriate and effective measures:

– **Keeping people in employment**, notably by providing financial support to temporary flexible working-time arrangements. Temporary adjustment of working hours ("short-time") in line with production needs can be an important source of labour input flexibility. By preventing mass lay-offs, this may mitigate the social impact of the crisis, save considerable firing and (re)hiring costs for firms, and prevent loss of firm-specific human capital. Such action needs to be combined with measures supporting employability and guiding people towards new jobs, empowering workers to take advantage of new opportunities when the upturn comes. These measures need to be coordinated to avoid negative spill-overs in other Member States.

– **Reinforcing activation and providing adequate income support** for those most affected by the economic slowdown, making full use of social protection benefits, in line with the flexicurity approach. In those countries where unemployment insurance is strictly limited

[8] COM(2008) 867, 16.12.2008.

[9] COM(2008) 813, 26.11.2008.

in time, consideration should be given to its temporary expansion and/or a reinforcement of minimum income provisions. Back to work incentives should be kept intact, and vulnerable groups supported in line with the active inclusion strategy.

- **Investing in re-training and skills upgrading** particularly for workers on short time and in sectors that are declining. Preference should be given to training targeted at future labour market needs, such as green jobs. Anticipation of future skills needs should therefore be promoted. Employment Services should be enhanced to cope with increased unemployment.

- **Mitigating the direct impact of the financial crisis on individuals** through specific measures to prevent over-indebtedness and maintain access to financial services. In countries with larger pre-funded schemes in their pension systems, the recovery of pension funds will be essential to protect the current and future income of pensioners.

- **Ensuring the free movement of workers** within the Single Market which will be the source of new opportunities. It can help address the persistence of mismatches between skills and labour market needs, even during the downturn. In this context, the Posted Workers Directive serves to facilitate free movement of workers in the context of cross-border provision of services, whilst effectively safeguarding against social dumping. The Commission will work with the Member States and Social Partners on a shared interpretation of the Directive to ensure that its practical application - in particular administrative cooperation between Member States - works as intended.

- Considering **supporting measures** such as lowering non-wage costs for low-skilled workers. Wage developments and fiscal measures should take account of each Member State's competitive position and productivity growth.

- Providing sufficient support to tackle **youth unemployment** and early school leavers. Time spent out of education or employment while young can have lasting effects. Member States should prepare for and encourage an increase in demand for **education and training,** as existing students stay on and displaced workers seek to re-skill. In this respect, future labour market growth areas such as 'green jobs' can already be anticipated.

- Integrating measures aimed at revising employment protection legislation within a **flexicurity approach** covering all its components so as to reduce segmentation and improve the functioning of labour markets.

4.2. An Employment Summit for Europe

A European approach can add value to Member States' efforts to meet the employment challenge, whilst avoiding distortive effects. The European Employment Summit in May will provide the opportunity to take stock of the developing situation, and to agree on further, concrete measures. It will be prepared together with the Social Partners and will build on the progress made on the Renewed Social Agenda over the last year.

The Summit should deliver three objectives:

- It should help accelerate recovery by focusing on structural reform to create more flexible, secure and inclusive labour markets.

- It should agree a concerted approach to reduce the social impact of the crisis.

– And it should launch a new consensus with Social Partners and stakeholders about how to modernise social policies to the mutual benefit of both employees and employers.

Particular focus could be given to measures to counter unemployment, with an emphasis on the integration of younger and more vulnerable workers into the labour market. The Summit should look at how EU policies can better support Member States' efforts, in particular in addressing the structural weaknesses of labour markets in line with the recommendations of the Lisbon Strategy for Growth and Jobs.

The Summit will be prepared together with the Social Partners and in consultation with all stakeholders. To collect input for the themes and possible outcomes of the Summit, the Commission will organise a series of workshops in a number of different Member States to bring together the European Parliament, the Social Partners, NGOs and civil society. This will complement the ongoing exchanges the Commission has with the Member States and with the Social Partners in the European social dialogue. This broad and open preparatory process should serve as a sound basis for building an ambitious consensus around a series of concrete deliverables in May.

5. PROMOTING GLOBAL RECOVERY: THE EUROPEAN CONTRIBUTION TO THE G-20 SUMMIT

This is a global crisis. The scale and speed at which a shock in one systemically important financial market soon affected the financial system and spilled over to real economies worldwide have shown just how interdependent the world has become.

The EU played a leading role in building recognition that global solutions are needed. Following the EU's initiative, the G-20 Washington Summit in November 2008 agreed an action plan to renew the international financial architecture to bring it up to date with the realities of globalisation.

The EU must continue to speak with one voice at the G-20 London Summit of 2 April. We can be a strong and influential partner in this work, given our long-standing and successful experience of regional market integration and effective institution-building.

As implementation of the European Economic Recovery Plan gains momentum, against the background of an ambitious reform of European financial markets, the European Union is particularly well-placed to take the lead in proposing concrete solutions that can deliver effective results at global level.

These efforts should be consistent with the need for global solutions in the area of climate change. The transition to a low-carbon economy should create new opportunities for growth not only in Europe but worldwide. The London Summit should therefore reaffirm its commitment to an ambitious global outcome to the UN Climate Change negotiations in Copenhagen in December 2009.

We should also ensure that the London Summit projects clear messages about the need to keep global markets open. Whilst there is a global recognition that the historical experience of protectionism in a downturn is disastrous, domestic pressures to apply restrictive measures can be strong. An unequivocal message is essential to hold off these threats.

Potential EU candidates and neighbouring countries are also feeling the impact of the crisis. The Commission remains committed to working with European and international financial institutions to support their economic stability and development. The Commission has welcomed the action plan developed by the European Bank for Reconstruction and Development (EBRD), the EIB and the World Bank, to deploy assistance to strengthen banks and support lending in some Central and Eastern European economies.

Finally, given the far-reaching effects of the global crisis and resulting slowdown on developing countries, we must uphold our commitment to help them through the crisis, out of poverty and into sustainable growth. Supporting them in pursuing the Millennium Development Goals is essential to global recovery in a sustainable open economy.

The EU must respect its Overseas Development Assistance (ODA) commitments, so that this, along with other available means, can be used to stimulate growth, investment, trade and job creation. Through the different Commission, Member States and EIB instruments, the EU should focus on activities such as agriculture, climate change and infrastructure where a direct counter-cyclical impact can be achieved. These efforts should be matched by strong responsibility by developing countries in ensuring good macroeconomic and fiscal governance.

At the **London Summit**, consistent with its ongoing internal decisions, the EU should promote agreement on a comprehensive set of concrete deliverables. The Summit should deliver firm commitments to **improve the global financial and regulatory system**, so that all relevant actors and instruments are subject to appropriate regulation and oversight, by:

– **Improving transparency and accountability:** Banking prudential rules as well as accounting standards should be improved by building in counter-cyclical mechanisms and properly addressing fair value. Bank capital requirements should better reflect liquidity risks and realign incentives on securitisation. The governance structures of the International Accounting Standards Board should be improved.

– **Enhancing sound regulation:** Regulation and supervision, and in particular the Basel Committee's prudential standards, should be extended to all relevant systemic actors – hedge funds, private equity, and other non-regulated credit institutions. Credit rating agencies should be subject to tough requirements to ensure the quality and transparency of ratings and that they are free from conflict of interest. Remuneration policies should be realigned to avoid short-term excessive risk-taking and to be subject to supervision.

– **Promoting integrity in financial markets:** A list of uncooperative jurisdictions should be drawn up together with a toolbox of joint measures for use against them in the areas of supervision, anti-money laundering, terrorism financing and taxation. Banks should be dissuaded from operating in off-shore centres[10] through increased prudential requirements and tougher transparency rules. The rules on holding and transferring intermediated securities should be harmonised at global level.

– **Strengthening international supervisory cooperation:** Global colleges of supervisors should be set up and given the powers they need to be effective. Supervisors should exchange good practice and promote global convergence of practices.

[10] The Commission will shortly make proposals on information exchange and transparency on taxation matters within the EU and with third countries.

– **The Financial Stability Forum** (FSF) should be enlarged ahead of the 2 April Summit, to include all major emerging countries and the European Commission.

– **Reforming the governance of the international financial institutions:** the London Summit should agree to a timetable for further reforms of the governance of the International Monetary Fund (IMF) and the World Bank. The system for top appointments to these two institutions should be reviewed.

– **Strengthening the IMF:** Member States should present a joint contribution to the temporary doubling of IMF resources. The IMF should strengthen its surveillance, by deepening the coverage of financial sector issues, reinforcing multilateral surveillance, and ensuring multilateral consultations including the orderly reversal of global imbalances. Cooperation with the FSF should be enhanced and effective joint early warning mechanisms established. FSF members and other systemically relevant countries should be assessed regularly by the IMF and vulnerabilities identified should feed into the early warning mechanism. Reforms should include internal procedures and should ensure that the key conclusions of IMF surveillance are fed into the International Monetary and Financial Council.

– **Developing the World Bank and Regional Development Banks:** The banks should implement the instruments at their disposal in a flexible manner to frontload assistance to mitigate the effects of the crisis, particularly for vulnerable populations. Adequate financing should be assured for their activities.

The Summit should **support balanced growth in global markets**, by:

– **Advancing global recovery through continued international coordination of fiscal measures** and their real impact. The EU is doing its part in the global effort to restore growth. International cooperation should ensure that the current fiscal measures are consistent with long-term fiscal sustainability. Moreover they should provide sufficient levels of investment in long-term policies, such as innovation, education, energy efficiency and the low-carbon economy. Once the recovery takes hold, an orderly and coordinated reversal of macro-economic stimuli is warranted.

– **Promoting open trade** as a complement to the fiscal stimulus. G-20 countries should strive for further global market opening. An early conclusion of the Doha round on the basis of the existing negotiating texts on agriculture and industrial goods is key. The London Summit should reaffirm a strong common stance against protectionism, in line with the standstill commitment agreed at Washington and the effective monitoring mechanism established under the WTO. G-20 partners should express their collective determination implement this commitment at the highest political level.

– Launching a **multilateral initiative on trade finance** that would reinforce the efforts of the World Bank Group and other relevant multilateral development agencies in expanding their trade finance activities.

– **Promoting global development** as part of the solution to the global crisis and a basis for peace and stability worldwide. The London Summit should reaffirm the commitment to supporting developing countries' efforts to generate growth and the fight against poverty, in particular by delivering on the Millennium Development Goals. To facilitate the active participation of developing countries in international trade, the G-20 should meet their aid-for-trade pledges and give duty-free and quota-free access to their markets for least developed countries.

6. CONCLUSION

This Communication sets out how the European Union can build on the steps already taken to address the financial and economic crisis. The EU is now entering a new phase of implementation of its Recovery Plan, with a need for effective co-ordination of the measures being taken to ensure that they work to best effect to help businesses, households and communities across Europe. This Communication echoes the discussion of the Heads of State and Government on 1 March 2009 and underlines that the road to recovery will be eased if measures in one Member State are shaped to spark an upturn in others. Effective coordination will make the single market a springboard for recovery.

The Commission invites the Spring European Council to:

- Agree on the need for a new package of financial sector reform measures including a new supervisory framework for the EU's financial sector, based on the work of the de Larosière group, and to decide on the main elements of this new framework at the June European Council, on the basis of further proposals from the Commission; and to invite the Council and European Parliament to give priority to the adoption of the proposals on financial services regulation to be proposed by the Commission in the coming months;

- Invite Member States to take the necessary action to ensure long-term financial stability as soon as economic conditions allow, in line with the revised Stability and Growth Pact;

- Invite Member States to expedite the implementation of their national recovery plans and structural reforms;

- Invite Member States to apply the common principles set out in section 3.2 when designing and implementing measures to strengthen the real economy;

- Invite Member States to effectively support people through the crisis, drawing on the elements for action outlined in this Communication;

- Endorse the process for the preparation of the European Employment Summit in May;

- Approve the joint European position for the G-20 Summit in London.