EXECUTIVE SUMMARY

THE IMPORTANCE OF STRUCTURAL REFORMS FOR GROWTH

Almost 5 years have passed since the outbreak of the global financial crisis. Yet Europe remains unable to return to a path of sustained growth. EU output remains below 2008 level, with 8 million people having lost their job since the start of the crisis.

Europe urgently needs to press ahead with structural reforms to both labour and product markets that can raise long-term output. By eliminating 50% of Euro Area countries' gaps with OECD best practise, Euro Area GDP could, within 5 years, increase by 3.75%.

REFORM PROGRESS IN 2012 AND BUSINESS PRIORITIES FOR 2013

→ Whilst many Members States made progress in structural reforms during 2012, companies continue to be concerned that such reform efforts lack the urgency that is clearly required. A survey of our member federations suggests the greatest improvements came in the area of financial stability. But reform progress in a number of areas impacting on productivity and investment, as well as trade and competitiveness, was much too slow.

→ BUSINESSEUROPE member federations continue to identify consolidation of public expenditure as the key priority for 2013. In addition, companies draw particular attention to the importance of growth-enhancing tax reforms, improvements in bank lending conditions, and enhanced sector-specific competition.

REFORM BAROMETER 2013: KEY RESULTS

→ In this year's Barometer, we focussed our indicators on benchmarking policies that are important for long-term growth, drawing attention to policy choices that governments can change directly or influence in the medium term.

→ We are not advocating that all Member States need to improve their performance in every indicator. Countries' specific circumstances influence the national policy framework, and different approaches can successfully achieve the same policy goal. Nevertheless, weak performance in any given area provides a good starting point for deeper analysis of possible underlying causes and for assessing scope for policy improvements.

→ We also believe it is important to consider both performance levels and the direction of change. This can reveal whether higher income European economies, while remaining frontrunners, are losing ground and risk becoming less competitive.

THE KEY MESSAGES FROM THE INDICATORS ARE PRESENTED BELOW IN **5 KEY INTER-RELATED THEMES**:

1. TAXATION AND PUBLIC FINANCES

KEY OBSERVATIONS

> Member States progressed in **reducing budget deficits**. In the EU, deficits fell from almost 7% of EU GDP in 2009 to less than 4% in 2012.
> **Effective corporate tax levels** have been reduced in recent years (particularly in Slovenia and the United Kingdom) but **overall tax rates** in most EU countries remain much higher than those experienced outside the EU.
> **Administration of tax systems** has been improved in a number of countries (e.g. Finland, and Bulgaria), but scope for improvement remains.

RECOMMENDATIONS

> Building on recent progress, further effort is required on **fiscal consolidation** on a number of Member States.
> To help reduce **overall tax burdens**, fiscal consolidation should focus primarily on reductions in current public expenditure protecting investment, not tax rises.
> Tax reforms should shift taxation away from labour and capital which are most damaging to growth and employment.
> Alongside national measures to **make tax systems more user-friendly**, Member States should harmonise administrative systems when possible, particularly for VAT.

2. BUSINESS ENVIRONMENT

KEY OBSERVATIONS

> **Administrative burdens** have been reduced in some countries (notably Slovenia and Bulgaria), but remaining divergences highlight scope for further improvement.
> **Market openness** varies widely between Member States, beyond that accounted for by differences in sizes of Member States' economies.
> **Energy costs** have increased considerably in recent years, with significant divergence between countries. Ireland and the Netherlands nevertheless demonstrate that governments do have policy scope to restrain energy price rises.

RECOMMENDATIONS

> **Regulation** must be designed to minimise administrative burdens.
> **Differences in market openness**, should be reduced by minimising the costs of enforcing contracts, properly transposing European directives, and ensuring most public procurement is advertised openly throughout the EU internal market.
> **Energy prices** must allow EU businesses to be competitive in international markets. Completion of the EU internal energy market and more balanced EU environmental regulation can help drive down costs.

3. INNOVATION AND SKILLS

KEY OBSERVATIONS

> **R&D spending** as a percentage of GDP remains stuck at around 2% in the EU, substantially below both the US and Japan.
> **Maths, reading and science:** performance in these key knowledge areas in most EU countries are now significantly lagging behind the best performing Asian economies.

RECOMMENDATIONS

> **R&D intensity** must be increased to reach the goal of 3% of GDP in R&D expenditures.
> **Innovation policies** must be more business oriented with targeted initiatives that stimulate private R&D investments and encourage clustering between public institutions, academia and businesses.
> Priority must be given to promoting **lifelong learning**, and complementarities between higher education and training to answer future skills needs.

4. ACCESS TO FINANCE AND FINANCIAL STABILITY

KEY OBSERVATIONS

> **Interest rates charged for bank loans** to corporations have increased in all surveyed countries. Rises have been strongest in peripheral economies of the Euro Area where sovereign borrowing costs have risen.
> **Banks' willingness to provide loans to SMEs** deteriorated over the last 18 months.

RECOMMENDATIONS

> Companies, particularly SMES, must be able to **access finance** on reasonable terms.
> New **regulation of financial services** should both increase financial stability, and ensure that banks are able to increase lending to businesses as the economy picks up.
> The Euro Area needs to make progress on implementing the **banking union**, notably the single supervisory mechanism, in order to reduce divergences in borrowing costs within the single currency area.
> **Alternative financing routes** to bank lending need to be facilitated.

5. LABOUR MARKET

KEY OBSERVATIONS

> **Unit Labour Costs:** countries with most rapid increases in ULC before the crisis, notably Ireland, Portugal and Greece have started making progress, but further progress is needed.
> **The tax wedge on low income earners** is much higher in most Member States than in Japan and the US. The UK, for example, has raised the level at which people start pay to tax on their earnings, making low paid work more attractive.
> Countries, notably Spain, France and the Czech Republic have started to make progress on **labour market reforms**, but much more needs to be done to reap all the employment benefits.

RECOMMENDATIONS

> Ensure **unit labour cost** rises are consistent with rises in productivity growth.
> Target cuts in **employers' social security contributions** to encourage them to hire more staff.
> Reduce tax burdens on labour to make work more attractive for low-income earners, compared with welfare benefits.
> All **contractual arrangements** must be designed with the primary goal of contributing to job creation.
> Ensure **retirement ages** evolve to reflect longer life expectancy.