Europe's 500 Entrepreneurs for Growth

WHITE PAPER

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How to solve the dilemma of stabilizing (public sector budgets, banks and currency) and maintaining growth at the same time?

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How to solve the dilemma of stabilizing (public sector budgets, banks and currency) and maintaining growth at the same time?

1 Introduction

1.1. The contradicting goals

Governments have successfully helped to overcome the crisis, but therefore logically had to increase the debt load dramatically. Banks are also over indebted for the opposite reason (which is connected with causing the crisis). Both need to deleverage, states and banks, which may cause a double stress to the creation of growth and jobs. In the aftermath of the financial crisis a lot of endeavors are therefore undertaken to stabilize the banking sector and to prevent reoccurring of such a dramatic pro-cyclical downward spiral chain reaction.

Still a lot more needs to be done and on top of all the currency tensions add complexity. The growth entrepreneurs are the engine for growth and jobs in Europe and got organized in the Europe's 500 Entrepreneurs for Growth Association (the Association). Growth and jobs remain top European priority connected to the goal of European competitiveness. The urgent call for sustainability and a carbon–low economy are an important source of growth and make our growth sustainable. But also sustainable growth is capital intensive especially in areas such as clean energy, recycling, clean water and emission reduction.

Governments are suffering high debts burdens and deficits as a double consequence of lower tax income and higher stimulus and bail out activities. It is obvious and undisputed that governments need to reduce spending, stabilize budgets and reduce or at least freeze the levels of debts. In this context the bank stabilization program and requirements such as Basel III and the reduction of states spending are both detrimental to growth and still unavoidable.

In this period of recovery the private sector needs to re-develop the necessary traction while at the same time credit from banks for the mid-size companies, SMEs and beyond, is logically difficult and may prevent growth to the extent that there can be the danger of stagnation like in Japan. There is plenty of liquidity in the financial markets but very restricted to liquidity for the real economy. In addition the growing industrial competition is even harder by smaller environmental and social standards in the emerging markets.

This White Paper is initiated and developed by the Association and wants to suggest additional concepts of how to escape from the dilemma (of stabilizing the government budgets and the banks and still have growth at the same time).

1.2. Deleveraging of banks and states may prevent growth

For the required financial stabilization, bank lending and state lending would need to be reduced which means that money that could go into investments and growth, would instead be used for debt reduction at the expense of growth and jobs.

We, the public, have to better understand to which extent the government debt reduction is necessary and healthy as they vary so strongly from country to country.

It is undisputed that governments need to achieve a financial equilibrium and healthy numbers and it is also undisputed that banks need higher equity ratios to stand more solid against future cyclic stresses.

As a result banks will need to raise more equity with lower returns. This may lead to continued reduction of lending and pushing down growth. This is obviously the reason why bank deleveraging may reduce growth.

Basel III requests the further increase of bank equity in relation to total lending, especially more equity of lending to the up to mid-sized companies (which employ 80 % of the European workforce). 3 % more equity requirement takes away approx. 25 % of the lending capacity to the real economy.

The real economy is being unjustly hit and thereby especially the job creators. The crisis had been caused by the abuse of regulatory freedom within the financial markets and needs to be repaired within this field without hitting the real economy. The Association is offering recommendations for this purpose within this White Paper.

1.3. Continued necessity of growth

In the spirit of sustainability and wealth compared to the developing world a shift in the opinion can be recognized critical to unguided growth. The question is often asked: why should we not be more modest, renounce on growth and wait for the third world to catch up in a sustainable way? (Japan example)

The entrepreneurs want to make aware and are in line with almost all other interest groups that a lack of sustainable growth in Europe will lead to more poverty and hit the low income population, the retired etc. unnecessarily strong. Therefore, sustainable growth is good and necessary for our society to cope with international competition and the continuous increase in automation and technical progress. It will however be necessary to prove to the public that European growth can be job creating without increasing emissions, energy use and the use of scarce resources. This should not be difficult, because growth can happen in recycling, in health, in the service sector, in green energy and in many areas that do not cause more emissions but the opposite.

We suggest to find a language that supports the general consensus for carbon neutral growth or similar and to develop a strategy that allows continued growth and stabilizing at the same time.

2. Recommendations:

2.1. The public sector

We need to develop a more complete (multi-parameter) standard of what is a healthy national and European balance sheet in order to make the debate less fearful and more fact-based and to prevent over-reaction. There should be a healthy level of debts that can be maintained, especially if we see the large spreads in Europe between 80 % and e.g. 160 % debts to GDP in Italy. We are being more nervous about Spain, even though the debt to GDP ratio in Spain is still below 100 %. We therefore see that there is a need for a macro-economic and understandable consensus model on long-term sustainable healthy indebtedness in relation to e.g. GDP, tax income, saving rates, growth, trade balance and other key performance indicators.

If this is achieved, there should be different debt levels allowed depending on such other parameters and we may find out that not everybody has to lower its debt level and that the public debate can be led on more logical and objective criteria. If there is a public available benchmarking for a healthy and competitive nation's balance sheet and performance, the envisaged European Monetary Fond can be based by on much broader consensus and support and does not risk becoming an uncontrolled power by itself. The healthy nation benchmark should help to enhance support for actions by higher transparency.

For the financially weaker Mediterranean EU nations there may be merits to consider to issue interest free inflation protected bonds that save cash flow to the state budget, but give some attractive safety (as an alternative to gold and real estate) to the bondholder.

The Association proposes to develop and co-publish an annual HEALTHY NATION MONITOR in order to help creating consensus and awareness for the Benchmark in cooperation with other associations and the Commission.

2.2. The bank rules reforms

Comparable to the US TARP (Troubled Asset Relief Program) governments or the EU should supply subordinated, interest bearing loans to the relevant large banks to an extent that they can maintain their lending to the mid-cap companies (that are too small to have direct access to the bond market) and there should be a duty of such banks to accept these or to issue the necessary amount of perpetual tier one bonds;

The Basel III equity rules should clearly distinguish equity requirements for the real economy and equity requirements for pure financial assets to draw a clearer line between the inter-financial markets and the classical direct savings that should get deployed into the real economy (the classical good old system).

We fear that the mix of investment and commercial banking in the same balance sheet does not help because overlaying this effect with Basel III requirements the commercial lending will continue to be the unloved child. We, therefore, think that the current reforms and mechanisms may have a negative effect on the real economy. The banks shall recover but this should not necessarily lead to a slow down of growth in Europe.

The current industrial recovery of 2010 has to do with a rebound in the use of idle capacity which works without investments and without loans. Therefore, the current recovery did not show the demand of credit that we are foreseeing in the future. The actual rebound is misleading and does not yet tell us that the European growth is healthy and sustainable. As bank reforms are highly complex, they are drafted between specialized experts and bank representatives and incomprehensibly the growth entrepreneurs from the real economy are not invited and not involved.

Our strongest recommendation is to have entrepreneurs and especially the growth companies included in such bank reform committees because the growth companies are those who may invest more than they have cash flow, who have more ideas than money and who are important leaders of the engine of growth and jobs in Europe.

Summary:

- **Bank accounting must allow a separation of commercial banking (lending) and other assets (investment banking) in the balance sheets.**

- **Subordinated interest bearing government loans or tier one perpetual bonds should become mandatory to stabilize the real economy bank portfolios to the extent required by Basel III to prevent reducing the credit portfolios. The real economy lending must grow in line with the economy.**

- **Growth entrepreneurs need to participate in the bank reform committees.**

2.3 Alternative growth financing for the real economy

As bank managers get punished if loans get lost, but insurance managers get rewarded if they can insure additional risks that can be statistically dominated and controlled, we suggest to explore insurance principles for long-term growth and capex financing for the mid-size companies.

If companies that have not used up a reasonable and healthy leverage, have difficulties in funding further expansion or modernization investments, they should have the option to pay for a credit insurance for such loans (for example a 6 or 8 year amortizing investment loan). Insured borrowers must agree that their risks individually and sector wise will be re-assessed every year and that the risk premium for keeping this insurance will therefore be re-adjusted every year.

As a consequence, insurance companies can earn money by the statistics of uncorrelated high numbers of calculable risks.

The banks will be relieved from the strict Basel III underlying capital requirements for mid-sized lenders and can treat such loans as if they were giving a loan to a AAA or AA large insurance company. By this insurance principal the rating of the mid-sized companies can be enhanced and mid-sized companies may gain the same access to capital as the large companies. Such a financing channel redistributes risks in a win-win manner and does not burden government budget and does not increase the bank risks. It would be an additional channel of funding the necessary growth in Europe without putting stress on the overall goals of increasing stability in the public and financial sectors.

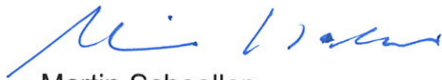
The Chinese are winning on many export markets by offering financing (also long-term) to their customers abroad. This transforms their role from being a supplier into being a partner and friend who makes projects possible. Europe should learn from this very intelligent and constructive strategy.

We do have government guarantees available to cover the economic and political risk for exporters but the implementation of such export guarantees and financing is too bureaucratic and therefore it does not fully reach its purpose.

Summary:

- **Build an INVESTMENT CREDIT INSURANCE FUND to enable top rating for insured mid-cap borrowers. The governments may need to give a paid for re-insurance until the critical size is reached.**

- **Simplify and improve the export financing procedures. This may have a very strong impact on the increase of exports and support the future long-term relation with the international customers (see Chinese example).**



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