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Restoring growth in Europe: confidence, reforms and investment

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

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Ladies and Gentlemen,

Many thanks for the invitation to give this dinner speech in your anniversary event. I would like to start by congratulating the alumni, faculty and friends of the Programme on International Legal Cooperation of the Institute of European Studies of the Vrije Universiteit Brussel for the 40th anniversary, and pay tribute to you for your high quality research and teaching. Your work continues to provide a very important contribution to building a strong, stable and prosperous Europe, particularly in the fields of European law and policy-making.

Let me this evening discuss the economic situation of Europe today, our crisis management and Europe's strategy to restore sustainable growth through three overriding elements: confidence, reforms and investment.

The crisis has ravaged the European economy and affected the jobs and welfare of millions of Europeans. As a result, much of Europe's economic potential is left unused. But, the state of the European economy today has to be painted with many colours, and it leaves one with a very dualistic picture. To the north and centre of Europe, especially Germany, we see continued recovery and job creation. Meanwhile, in the periphery, many Member States are suffering from a severe recession and rising unemployment.

Against this background, there are two key questions: What has the European Union done to overcome the crisis? What can be done to restore stability and growth? To answer these questions we must first look at the origins of the crisis.

The current crisis was triggered by the bursting of the US subprime bubble in 2007 and culminated in the collapse of the Lehman Brothers investment bank in September 2008. It led to the draining of interbank lending and subsequently to a fully-fledged financial crisis of global proportions. And it led to a global economic recession, sometimes dubbed as the 'Great Recession' – as if there were anything great in recessions! Essentially it was a crisis of global financial capitalism.

The response was effective global policy coordination among governments and central banks in the context of G20, using the resurrected Keynesian toolbox of massive fiscal and monetary stimulus to the full. In Europe, at the initiative of the Commission, the EU member states adopted a European Economic Recovery Plan, which prevented the recession from turning into a long and deep depression, and thus averted devastating economic, social and political consequences.

Yet, the crisis also exposed vulnerabilities that had been built up in Europe during the first decade of the euro. In a context of excessive global liquidity and mispricing of risk, weaknesses in the design of the Economic and Monetary Union had allowed the build up of significant fiscal and macroeconomic imbalances in the years before the crisis. With the possible exception of Greece, fiscal weakness has been a result rather than the cause for the crisis: the level of public debt rocketed on average from an already significant 60 % to 90 % in four years, caused both by the falling output and, to a lesser extent, by the fiscal stimulus to tackle the crisis. Once again, the evolution in public debt has varied among the Member States. In many Member States, very high levels of public debt have made public finances vulnerable and burdened their economic dynamism and medium-term perspectives for sustainable growth. This has been a striking feature of the current crisis in comparison to previous episodes of crisis and recovery, since in the present situation the core problem is less the increase of debt as such than the much higher level of debt from which the increase started.

A key characteristic of the crisis has been the interconnection of the sovereign debt markets and the banking sector. As sovereign yields have moved sharply higher, investor confidence in the quality of bank balance sheets – holding significant amounts of sovereign debt – has been undermined.

The intertwined and toxic combination of the sovereign debt crisis and banking sector fragilities, together with sluggish growth, has created a vicious circle, which must be broken before we can expect to leave the crisis behind us. The vicious circle was particularly intense in the final weeks of 2011, when investor confidence in euro-area sovereign debt market and banking system reached its lowest level. But, the last weeks of 2011 were also the crucial turning point, as the EU leaders then chose to go for deeper integration and economic union instead of giving up to the threat of a gradual disintegration.

At that critical point they opted for a decisive policy response along the lines of the Commission's roadmap for stability and growth. This response is built on restoring confidence by solving the sovereign debt crisis and mitigating the banking sector fragilities, while at the same time pursuing structural reforms and enhanced economic governance.

We have in the past two years completely overhauled and reinforced the rules and practices of economic governance in the EU. With the strengthening of the Stability and Growth Pact and with the new Macro-economic Imbalances Procedure, the most important instruments of the new governance system are in place and now being applied. The member states' commitment to this direction is confirmed with Fiscal Compact Treaty, which is in the process of ratification.

In addition, we are about to conclude the second cycle of economic policy coordination under the European Semester. One important task this year is to establish a strong and consistent track record of the new economic governance as a pre-condition for any deep integration towards a genuine economic union.

While fiscal consolidation is unavoidable and structural reforms the key to growth in the medium-term, active public policies to promote sustainable growth are equally important. President Barroso, in his State of the Union speech in the European Parliament last September, said: "We need stability but we also need growth. The economy can only remain strong if it delivers growth and jobs. That's why we must unleash the energy of our economy, especially the real economy."

The Commission followed up on this commitment with the very concrete and ambitious proposals in its Annual Growth Survey last November, fully in line with the Europe2020, our joint strategy for growth and jobs.

We now have to turn words into action, as the economic dynamism of Europe and its capacity to create welfare for its citizens is at stake.

There is no breathing space – we must move on and maintain the momentum of decisive policy action. We have three building blocks to enhance substantial growth and job creation in the European economy.

The **first building block** is that **fiscal consolidation**, while necessary, is done **in a growth-friendly and differentiated way**, in order to strike a balance between necessary fiscal consolidation and concerns for growth.

Contrary to the misleading impression promoted by some politicians and pundits that the EU fiscal framework forces all member states into a 'one-size-fits-all' consolidation straightjacket, the Stability and Growth Pact is **not stupid**. Yes, the EU fiscal framework is rules-based, with clear reference values for public deficit and debt for triggering the excessive deficit procedure and, if needed, sanctions. But, at the same time, the Pact entails considerable scope for judgement, based on economic analysis and its legal provisions, when it comes to its application. The Pact underlines the structural sustainability of public finances over the medium term and implies differentiation among the member states according to their fiscal space and macroeconomic conditions.

These principles are well reflected in the fiscal exit strategy agreed by the ECOFIN Council latest in February. It calls on those Member states that have better fiscal space to let the automatic stabilisers function fully. Meanwhile, vulnerable Member States under close market scrutiny need to convince both the market forces and policy-makers over their capability to tackle the fiscal challenges and thus create confidence. In essence, the road to medium-term economic sustainability goes through immediate decisive action in structural reforms and financial stability.

The Commission is at the moment assessing the stability programmes presented by all Member States by the end of April. Based on the principles of the Stability and Growth Pact to which I just referred and taking into account our Spring Forecast of 11 May, we shall propose a common policy approach for the euro-area as a whole and accordingly make country-specific recommendations in the end of May.

The **second building block** is based on the acknowledgement that the current crisis does not have only fiscal roots, but it has **its deeper origins in macroeconomic imbalances and divergences in competitiveness**. The first decade of the euro saw an accumulation of substantial external and internal imbalances fuelled by cross-border capital flows in search of yield. Low financing costs and other factors resulted in a misallocation of resources to less productive uses, feeding unsustainable levels of consumption, housing bubbles and accumulation of external and internal debt. We are now systematically addressing these matters, to prevent repetition of such events. We will monitor carefully, and issue recommendations when necessary. We are currently preparing 12 in-depth studies to be presented in late May.

All in all, we need to maintain the momentum of the wave of reforms that is currently moving in Europe, especially in the countries that have for long needed them most.

Thankfully, we have many encouraging examples showing that restoring confidence in public finances and implementing ambitious structural reforms does work and pave the way for sustainable growth. Countries that have best weathered the storm are those that have gone through such adjustment in the recent past. Just look at Denmark and the Netherlands in the 1980s, Finland and Sweden in 1990s, and Germany in the first decade of this century.

The **third building block** is that we **need to further boost investment to supplement the other policies of our growth agenda**, such as growth-enhancing structural reforms and the completion of the Single Market. More precisely, we need more European cross-broader and community investment in infrastructure – energy, transport, innovation, research and communications.

This is consistent with the findings of the imbalances analysis, which point to targeted public – and private – investment as a relevant growth lever. Under certain conditions, investment in surplus countries could be beneficial to reduce the macro-economic imbalances.

Despite these needs, investor risk aversion is reducing the number of new projects, while financing opportunities are constrained because the private banking sector is still recovering from the effects of the crisis. . Thanks to the ECB's actions, recent survey data point to some improvement in the availability of credit for investment, but we are by no means out of the woods. So there is a key role for public banks and also public investment.

But we have to be innovative. Therefore the Commission last year proposed the creation of project bonds for infrastructure investment, which is a new tool to unlock private funding. We proposed to use the EU budget and the EIB for limited risk sharing with private investors. I expect that legislative procedures can be concluded in June, so that the first project can get on its way in few months time.

We are currently exploring how we can build on this and expand further risk-sharing instruments to un-lock private investment. In particular, we are exploring whether structural funds can be reprogrammed as has been done recently with Greece. This can be effectively done through guarantee funds for SMEs in order to help their often too tight financing conditions. Innovative and competitive SMEs all over Europe need to be ensured the availability and affordability of financing that allows them to grow and prosper.

With the European Investment Bank, the EU has a powerful institution to support growth and employment. The EIB, with a lending capacity several times the size of the World Bank has been playing a key role in tackling the crises since 2008. But it is reaching the limits of what it can do with its current capital base. To allow the EIB to do more for growth and jobs, its capital needs have to be addressed.

One area where investment needs in the EU – as well as prospects for growth – are more than substantial is green growth, which is a key objective of the EU's Europe2020 strategy for growth and jobs.

While industrialisation and growth in the past two centuries were marked by abundant and cheap resources, the same thing cannot work in the 21st century. Instead, we need to pursue growth that is based on low-carbon and resource-efficient solutions. It is also a matter of reducing Europe's excessive import dependency in energy production, which is burdening our external balance and thus economically detrimental.

And that calls for more investment as part of the broader approach of greening our economies. It is a core part of our green-growth strategy that focuses on integration between resources and economic sectors and pursues a right policy mix of regulatory, market and voluntary measures and investment incentives.

Finally, looking beyond immediate fire-fighting and economic crisis management, we need to focus on tomorrow's challenges and consider next steps in strengthening the euro-area governance, its institutions and instruments. Therefore, the Commission presented the Green Paper on Stability Bonds last November. It opened up a useful public debate, not least thanks to the European Parliament.

We underline the basic principle of sustainability: Further sharing of risk would have to be balanced by provisions that ensure sustainable public finances and minimise the moral hazard. Stability Bonds would have to go hand in hand with a substantially reinforced fiscal surveillance and policy coordination, that is with deeper fiscal and economic integration.

Ladies and Gentlemen,

Let me conclude. Over the past two years we have made great progress in strengthening the foundations of the Economic and Monetary Union and in containing the financial crisis.

Now, while we continue working on to these two issues, we need to step up our collective efforts for boosting growth. The growth-boosting initiatives I outlined could in the Commission's view be combined to create a European investment pact. We need to enhance public investment and use it in a smart way to unlock further private investment. While the single market remains our main growth engine, this kind of investment pact could provide necessary additional fuel for the engine.

That is an essential element in the way out of the crisis and towards sustainable growth and job creation. Thus, we continue forward towards an ever stronger and more integrated Economic and Monetary Union, which will help in delivering European citizens the welfare they deserve.