WELCOME AND KEYNOTE SPEECH
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EU CONTRIBUTION TO A SOUND AND SUSTIANBLE GLOBAL ECONOMIC RECOVERY: ENHANCING GROWTH THROUGH SMART CONSOLIDATION AND STRUCTURAL REFORMS

Ladies and Gentlemen,

It is my great pleasure to welcome you to this workshop organised by the European Commission to mark the occasion of the Shanghai World Expo. I am sure that it will provide an excellent opportunity to exchange views among people with extensive experience and intensive insights in economic and financial policy making. Thus, I am particularly delighted to welcome Mr. HU, Vice Governor of the People's Bank of China and Ms. TUMPEL-GUGERELL, a Board Member of the European Central Bank, to share with me this opening panel.

The focus of the workshop is on contributions that the EU and China can make to a sound and sustainable global recovery. [SLIDE 2]. Let me say a few words about the programme for this afternoon.

Following the opening session, we will have a panel on financial markets. The depth and scope of the past financial crisis forged quickly global consensus that regulation and supervision of the financial sector had to be thoroughly overhauled. The accumulation of excessive and ill-managed risks in balance sheets of financial institutions was at the core of the crisis and the ease and speed of contagion to other institutions. Regulatory reform in financial sector had to address these malfunctions. While we have well advanced, major work remains still ahead of us, including increasing the transparency of financial markets and strengthening shock resilience of banks. It is significant that we will have frank discussion on this here in Shanghai – an increasingly important world financial centre.

The second issue we will address today is the avenues for future economic and financial cooperation between the EU and China. To date, EU and China have had discussions on major economic issues within the macro-economic dialogue. Such dialogue will remain important given the scale of global economic challenges now and the fragility of current recovery. It would require even more intensive working together to contribute to sustainable global growth and sound financial markets.

To set the scene for this workshop, let me recall the conclusions of the Toronto G20 summit earlier this week. [SLIDE 3] The G20 leaders confirmed that our highest priority is to safeguard and strengthen the recovery and lay foundation for strong, sustainable and balanced growth, and strengthen our financial systems against risks.

This is a difficult task. Today we face economic challenges of unprecedented proportions. In Europe, this crisis has been the most severe in the post-WWII era. [SLIDE 4] It wiped 4% off GDP in 2009 and set back industrial production to 1990 levels. Since 2008, the number of unemployed has jumped by 4.5 million. Banks have been significantly weakened in terms of their capacity to provide financing to businesses and households. [SLIDE 5] Moreover, the crisis has taken an unprecedented toll on public finances. Average deficits are now reaching 7% of GDP and debt levels have increased by 20 percentage points of GDP in two years, thus undoing 20 years of consolidation. A number of EU Member States find themselves in positions of extreme economic distress. Starting with Greece, financial markets have raised concerns over sovereign debt sustainability reflected in spreads attached to the debt of several euro area countries with severe fiscal and competitiveness challenges [SLIDE 6]. Confidence has been undermined in a fundamental way.

The economic reality is ruthless. If policies are kept unchanged, economic growth will be extremely slow implying at best a very gradual recovery after the sharpest contraction since the 1930s. This would mean high and lasting unemployment, negative effects on social cohesion and welfare states, high public debt constraining the scope for investment, and ultimately, lower standards of living. Given its impact on public finances and potential growth, the crisis would then also render the mega challenges of globalisation, demographic ageing, and climate change much more difficult to handle.

While the task of sustaining recovery and safeguarding growth is difficult, I believe it is also surmountable. In fact, the EU has moved to put in place such a policy framework and whilst the task is far from complete, we have built the foundations for success. The significant, fast and coordinated action taken since the wake of the crisis – by EU and other countries across the world – has been commensurate with the unprecedented challenges and successful in averting major risks. Let me recall some of the policy responses we put in place in the EU. [SLIDE 7]

- In 2008, we adopted a European framework for government assistance to support the financial system recover from the crisis. EU Member States provided public assistance to struggling financial institutions – including guarantees, capital injections, impaired asset relief, or liquidity provisions – amounting to an extraordinary 31% of EU GDP. And we have advanced, within the EU, and more widely in co-ordination with major other countries, in improving governance, resilience and transparency of financial system. [For example, the Directive on Deposit Guarantee Schemes and the Capital Requirements Directive were revised swiftly. A regulation on Credit Rating Agencies was adopted and the Commission has presented two Recommendations on remuneration principles and proposed a Directive on Alternative Investment Funds.]

- Responding to the recent worsening in confidence, the euro area and the IMF provided a massive rescue package for Greece, under which the country has committed to a tough programme of budgetary consolidation combined with ambitious structural reforms. This helped to ensure the solvency of Greece and to stabilise the financial sector in the euro area as a whole.
- Safeguarding financial stability in the euro area has required exceptional measures. In particular, the EU has created a European Financial Stabilisation Mechanism, complemented by a European Financial Stability Framework, which provides a backstop of up to 500 billion euro that largely respects the basic principles for a permanent robust crisis resolution mechanism.
- To support the real economy during economic slump, the EU implemented the European Economic Recovery Plan that helped sustaining demand and employment, and ensured support to vulnerable households and viable enterprises. The total fiscal stimulus in the EU amounted to almost 3% in 2009-2010.
- This year, the EU has formulated exit strategies for crisis-related measures in the financial sector, public finances, and in the real economy. These strategies are based on a prudent approach to "growth-friendly" fiscal consolidation in line the agreement reached by G20 leaders in Toronto last Monday. We believe that sound public finances are essential to sustain recovery, provide flexibility to respond to new shocks, ensure the capacity to meet ageing challenges, and ensure sustainable debt levels. But for fiscal

consolidation to be plausible it is necessary to have prudent assumptions about economic growth and on strong budgetary frameworks. It is also important to elaborate clear medium-term strategies for putting public finances on sustainable path. Finally, it is important for the consolidation to be 'smart'. That means when considering consolidation measures, it is essential to keep in mind their effects on growth because some types of expenditure are more growth friendly that others; and some taxes more harmful that others. Therefore, smart consolidation implies important choices that can be also instrumental in putting in place right incentives.

- To be successful, consolidation must be supported by a sound growth strategy. This is precisely why the EU has adopted the Europe 2020 – our own growth strategy for the next decade. It brings together reforms that improve potential output and growth, such as reforms of the labour market, research environment and education system, and product market reforms. By removing impediments to job creation, investment and productivity, structural reforms can increase the rate of economic growth and directly contribute to budgetary consolidation through higher tax revenues and lower public spending on social transfers.

The potential benefits of coordinated growth strategy can be very significant. [SLIDE 8] According to the Commission estimates, if we implement ambitious structural reforms in the coming 5 years, we have the potential for over 2 percent annual growth rate in the coming decade. This may sound limited to a Chinese audience [SLIDE 9], but it comes on top of much higher per capita GDP level (21,000 euro per capita (PPS) in EU27 in 2009 i.e. more than 10 higher than in China) and would double the rate some observers fear would result otherwise. This could create over 10 million jobs and generate additional output equivalent of some 1 880 euro per person by the end of the decade.

To succeed with these ambitious tasks, we need a new set of rules for economic governance and policy coordination. The crisis and the associated contagion risks have exposed the interdependence of Member States, in particular inside the euro area. It also revealed clear weaknesses in our economic governance as regards budgetary and broader macro-economic surveillance.

This week, the Commission made concrete and operational proposals for reinforcing economic policy coordination. [SLIDE 10] In particular, the Commission proposed the creation of a framework for broader economic surveillance, including macro-economic imbalances; an enhanced agenda for structural reforms; and a set of measures to ensure that national budgetary frameworks are credible and sound, and debt is returned to sustainable levels.

In order to address one of the key drawbacks in existing governance, we proposed a step-change in European economic policy coordination. We propose that budgetary and economic surveillance is performed at an early stage of national budgetary process, allowing competent national authorities to be much better informed of the European perspective and to receive timely and prudent guidance for decisions under national rules and procedures. The credibility of the EU's fiscal surveillance framework will be strengthened through appropriate sanctions and incentives.

Ladies and gentlemen,

History has shown that recoveries after financial crises are particularly slow. History also teaches us that crisis can offer a window of opportunity to build foundations for stronger and more sustainable growth in the future.

Ultimately, whether or not we can emerge stronger from this crisis will depend upon credibility of policy responses we put in place, and reforms we introduce to improve functioning of markets, boost growth, and make our economies more fit to address the long-term challenges. As we stated in Toronto this week, EU is determined to realise its commitments to support and strengthen the global economic recovery and to contribute to sustainable and balanced global growth.

Thank you for your attention [SLIDE 11]

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