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Coping with the crisis. How has the world changed?

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Ladies and gentlemen,

Let me first thank Commissioner Rehn for inviting me to talk to you today. I would also like to congratulate both him and his staff in the Commission's Directorate General for Economic and Financial Affairs, for organising this eleventh edition of what has become one of the most important European and international platforms for debate on economic issues.

We are currently going through a financial and economic crisis of a magnitude not seen since the Second World War.

In my speech I would like to give you a very condensed reading of the type of issues the crisis has confronted us with, and the way I believe we need to address them.

Taking a bird's eye view, economic policy making in the EU is currently facing among others three major challenges: first, we need to ensure a constructive interplay between national and European considerations; second, we need a more sensitive balance between the effectiveness of market forces and economic cohesion; and third, we need to deliver economic and fiscal adjustment while protecting growth.

I will discuss these three challenges in turn.

Economic crises, especially those with a global dimension, typically give rise to two opposing reactions or reflexes. They sharpen our awareness of the deep interdependence of our financial and economic systems. We move closer together because we understand that viable and sustainable solutions can ultimately be achieved only through increased co-operation.

However, crises also provide fertile ground for voices peddling short-sighted national interests. These include calls for protectionist measures and unilateral action.

Over the past two years as well as also over the past months we have seen both.

If, in the end, we managed to contain the second reflex, it was in large part due to decisive action at the EU level, in combination with a revival of global governance instruments, in particular the G20.

Nevertheless, the economic downturn has been, and continues to be, a major setback in terms of income and employment. However, we were able to couple, in some areas, strict EU solutions (what we normally call the solutions of the "Community method") with inter-governmental action and put them both in a common European framework. I believe it is fair to say that without such a framework, the situation - especially during the recent debt crisis in some Member States - would be less benign, to say the least.

I also think the crisis has highlighted the adaptability and flexibility of the Community approach. Take for example the recent decisions concerning Greece. Under rather difficult circumstances we managed to bring intergovernmental instruments such as bilateral loans into the Community architecture. It wasn't evident at all in the beginning. The negotiations in Athens were led by the Commission against the backdrop of an intergovernmental agreement of Member States to provide financial assistance.

Another good example of the successful interplay between the intergovernmental and Community approach is the financial support mechanisms agreed by the Ecofin Council on 9 May to preserve financial stability in the euro area.

As you know two mechanisms were agreed which put in a common European framework the provisions of the Treaty and the intergovernmental agreement of the euro area Member States. All this was based on a proposal from the Commission. In one case based on article 122 of the Lisbon Treaty, in the other case on the intergovernmental contribution in the European framework.

In fact, at the meeting of the Eurogroup at the level of Heads of State and Government which met on the evening, and night, of the Friday before, I announced that the Commission would already come with a proposal for the Sunday Ecofin. This was necessary for the Council to be able to decide.

The Commission met on Sunday morning and the proposal was on the table of ministers in the afternoon! On the substance, the Commission made clear that whatever mechanism was created, its financial capacity would have to go well beyond what was allowed by the Community budget. In fact to protect the euro, significant financial means would be required.

Member States were made fully aware of their responsibilities: were they willing to save the euro or were they not?

Not all Member States were prepared to agree to the level of ambition of the original Commission proposal, but in the end a very good result was possible. A total amount of up to €500 billion was made available apart from the contribution from the IMF.

The Commission will also play a leading role in the design and implementation of the two mechanisms. In particular, in designing possible future programmes, with the ECB and the IMF, regarding conditionality, and naturally in assessing the implementation of such programmes.

From this point of view, we proved again that the EU is more then 'just' an international organisation. Five decades of economic and institutional integration have formed an order of shared peace and prosperity, something we – that is the Member States through the EU institutions - want to defend and project into the future.

Without any doubt, the past two years have been a difficult test of our capacity and willingness to find common solutions to common problems.

And two years ago, when we commemorated ten years of the euro, the Commission pointed out what it needs to consolidate it as a success: we need to increase economic policy coordination and economic governance in the euro area as well as address the problems of imbalances. This was on the 7 May 2008, exactly two years before we presented our proposals on reinforced economic governance.

It may be that at some point, with the benefit of hindsight, we will conclude that some issues could have been dealt with in a more efficient manner. However, taken as a whole, and considering that in Europe we have 27 Member states and 16 member states in the Euro area, it is difficult to deny that the Community method has worked and produced results.

Ladies and gentlemen,

The second major challenge for economic policy making relates to the dysfunctions and deficiencies in financial systems.

The financial crisis has not only threatened financial stability and dented economic growth.

For many citizens, the financial crisis has become a particularly drastic symptom of a deeper failure in our globalised economic and financial system.

Such concerns have to be taken seriously, and are being addressed. In fact, the very first actions in the early days of the crisis were based on the understanding that regulatory and supervisory instruments had to be strengthened, to deliver a sustainable and responsible, credible financial sector.

On the other hand, I now see in some market commentary what I would call an obsession with events in Europe, more precisely in the Euro area, to the exclusion of all else. A greater sense of perspective would seem warranted.

Having said this, events in Europe are our responsibility, and we have been quick to act as far as financial regulation is concerned. A number of initiatives have been launched by the Commission. Some are more advanced, others are still in the making. Let me just mention the most significant ones.

We are already working towards a better framework of supervision and regulation of banks and other financial institutions in Europe.

Concrete proposals for an integrated European supervisory arrangement – encompassing the European Systemic Risk Board and the three Supervisory Authorities - have already been put forward and are currently going through the EU legislative process.

The Commission's proposals are currently in the European Parliament, after having been somewhat diluted in the Council. It is urgent that we reach an agreement on these matters. The EU must have the tools to prevent future crises and to deal with emergencies if necessary.

New legislation for credit rating agencies, which play a pivotal role in the functioning of financial markets, will come into force in the coming months. But we need to go further, namely on supervision of the Credit Rating Agencies and on transparency as regards sovereign debt.

The Commission is also working on an overhaul of the derivative markets; we will propose legislation this summer. We are drafting proposals to improve depositor and investor protection which we will present in July, and to further improve the quality and quantity of bank capital.

Finally, the Commission will adopt tomorrow, Wednesday, a Communication on bank resolution funds. Member States will be invited to constitute national resolution funds, financed by the banks themselves in order to minimise the cost to taxpayers in the event of an orderly resolution of insolvent banks. This is a proposition on the bank levy. I think that even before we have an agreement at global level, we should agree at European level.

Because of the global dimensions of the issues involved, our efforts are not limited to the European level. The EU has been very active in shaping a process involving other global regions through the G20.

In fact, the EU has been an important driving force of the G20's activities since the onset of the crisis. Within this process, the Commission will continue to work hard to pool the interests of all 27 Member States effectively, not all Member states are in G20, and to make sure that the current momentum is preserved.

The EU must do what is necessary to complete its homework on financial regulation. Once again I ask Member states and the European Parliament to speed up their work.

The next G20 summit is scheduled to take place in about a month's time in Toronto. One important item on the agenda of that meeting will be the consistent implementation of financial market reforms. On that occasion the EU needs, and will push for, a rapid adoption of agreed reforms.

The common thread running through all these initiatives is clear. We want to maximise the protection of savers and investors, strengthen the stability of the financial system and, in turn, of our economies at large.

Achieving these objectives is fundamental. We need to prove to our citizens that economic and financial integration is a vital pillar of the European project, one that ensures prosperity and cohesion across its Member States.

Ladies and gentlemen,

Let me now turn to the third challenge of economic policy making the EU is facing. We have to find the right balance between unwinding fiscal imbalances on the one hand, and strengthening the growth potential of our economies on the other.

In most EU countries, economic activity is now gradually recovering from the deepest recession in decades, not least thanks to the fiscal impulse packages coordinated at the EU level.

At the same time, the crisis has taken a heavy toll on public finances. In many Member States, the current course of fiscal policy weighs heavily on the long-term sustainability of public finances, and requires corrective measures.

In addition, the crisis has bluntly exposed serious divergences of competitiveness across EU countries and - linked to this - a serious backlog of structural reforms.

Dealing with this trade-off between correcting fiscal imbalances while protecting economic growth will not be easy. But I am confident we have the right ideas and the right instruments to be successful.

I am thinking in particular of the strengthening of the EU fiscal and economic surveillance framework and the Europe 2020 reform programme.

The focus on fiscal and economic governance is primarily motivated by the need to redress unsustainable fiscal positions that built up during the crisis.

However, the root causes of the current situation of EU government finances go deeper. One of the bitter lessons we had to learn from the crisis is, indeed, that existing provisions of fiscal and economic governance did not succeed in encouraging Member States to take advantage of the good years preceding the sharp economic downturn.

Admittedly, in 2007 - the year before the crisis hit us - many Member States recorded fiscal balances which, on the face of it, looked pretty comfortable. In the euro area as a whole, the headline deficit declined to 0.6% of GDP, down from 1.3% of GDP in 2006, the lowest level in more than a decade.

However, the necessary room for manoeuvre was actually quickly exhausted or - to use a more dramatic expression - gambled away before the crisis started.

As the crisis unfolded, the ensuing free fall of revenues exposed the missed opportunity to consolidate, and weighed heavily on the available fiscal space.

This lesson is discomforting. For a number of countries a sounder starting fiscal position could have been achieved ahead of the crisis without painful fiscal adjustment. In many cases, simply keeping expenditure growth in line with economic growth would have sufficed to build substantial buffers that could have helped weather the crisis.

Clearly, public finances would have suffered during the crisis even if fiscal surveillance had worked in the years preceding the economic downturn.

However, we have to acknowledge the fact that some weaknesses in our surveillance system have made things more difficult, including the sovereign debt crisis. I am therefore happy to see that Member States now seem ready to confer audit powers on Eurostat, after opposing it five years ago when my first Commission presented such a proposal.

It is also of paramount importance that we strengthen the Stability and Growth Pact, and this must go hand in hand with the strengthening of existing institutions.

Let me be very clear on this point. I am very well aware of the role that institutions should play to secure fiscal rectitude and the implementation of fiscal rules. Both at national and EU level. But the solution is not to blur the responsibilities of the existing institutions. On the contrary, the solution is to reinforce them, namely the European Commission, the ECB and the role of ECOFIN.

The Commission's role in implementing the Stability and Growth Pact was always carried out in an independent and objective way. In most cases, the Council followed the Commission's recommendations. When it did not, as was the case in 2003, the Pact was put at risk.

So my advice is 'yes' to strengthen the Stability and Growth Pact, but also 'yes' to reinforce the institutions to which the Treaty assigns specific responsibilities on budgetary surveillance. It is impossible to reinforce the Pact without reinforcing the institutions that implement the Pact.

The first important steps in that direction have already been taken. Two weeks ago, the Commission adopted proposals to make fiscal and economic surveillance more effective.

The Commission will now move on to present concrete legislative proposals.

As I said before, our efforts to rebalance public finances and to enhance our fiscal surveillance framework are only one side of a more comprehensive policy scheme. Our efforts to secure fiscal sustainability need to be combined with the Europe 2020 strategy, for two essential reasons.

To start with, history provides abundant evidence that fiscal adjustment packages are more successful when combined with structural reforms. Success here means two things: a more lasting correction of public finances, and a beneficial effect on growth prospects.

From this point of view, the combination of fiscal austerity and structural reform must not be portrayed as a double burden. On the contrary, it is the approach that best suits our current predicament.

So we must implement with vigour our Europe 2020 strategy. We must address the labour market so that employment rates can increase and I see that now some Member states are ready to make some structural reforms that have been postponed for many years. We must look also at the quality of government expenditure so that our education and research and innovation targets can be met. We must reform our pension systems to ensure its sustainability. And so on and so forth. So I am happy see that some governments are now announcing very important and courageous reforms. It is interesting that this was not the case some months ago.

The reason why a combination of fiscal adjustment and structural reforms will not impinge on growth performance in the medium term is simple: structural reforms enhance an economy's competitiveness.

In the very short term, the medicine may taste bitter, but is necessary to restore credibility vis-à-vis markets and long-term sustainability of public finances.

But let's be clear: there is no alternative that promises a more comfortable way out. Any further delay of the reform agenda would simply make things worse and increase the costs of adjustment down the road.

These days, when discussing economic policy making, it is difficult to abstract from the crisis. Nevertheless, it is important to remind ourselves that a comprehensive structural reform plan would have featured prominently on the European policy agenda even if the crisis had not taken place.

Indeed, and some of you will remember well, when we presented the Europe 2020 strategy, even before the latest developments of this crisis, we have said that it would be impossible and indeed irrational to separate the Stability and Growth Pact from the structural reform agenda. At that moment our proposal was not very well received in some quarters because some said that linking the two would weaken the Stability and Growth Pact. As of now everybody understands and accepts that indeed it makes no sense, when we discuss the economic policy in Europe, to separate, as if they were completely different, the efforts in terms of fiscal consolidation and the efforts in terms of the structural reforms. We need to have a holistic approach towards those aspects by linking it as well to the external agenda, namely trade and investment, and regulation and supervision, because all these points have to be tackled in a holistic manner. That is the only way to have a coherent economic policy for Europe and its Member states.

We already realised many years ago that we must restore economic dynamism to safeguard our prosperity in a changing and increasingly globalised world. The crisis has simple acted as a wake up call. I hope this time it will be heard by all of us.

No doubt, structural reforms are never easy. There are serious obstacles to overcome in our societies and sometimes in ourselves intellectually, politically. But we have reached a point were procrastination is no longer defensible.

We agree that reforms are urgently needed.

We agree that the reform plan outlined in the Europe 2020 strategy is the right approach to achieve stronger, sustainable and inclusive economic growth.

We should also agree that our chances of success are much higher if we act together, if we address the economic challenges in concert, rather than in an un-coordinated way. We cannot be selective when it comes to implementing the European instruments. I see some politicians who are very enthusiastic about reinforcing the Stability and Growth Pact but not so much about reinforcing economic coordination. I see others that are very enthusiastic about the common approach, but they do not want to respect the rules of the internal market. We cannot be selective when it comes to European instruments if we want in the end to have a common approach where the idea of fairness is essential. We have to work with all the Member states and the European institutions to remind everybody that rules have to be respected if we want to be in a community of values and not just in a system where some have more influence than others. That is why we are coming to a decisive moment not only from an economic policy point of view, but also from a political point of view. And now we are in this situation where the message given by the political system and by the markets that are asking for more coherence in the European area are indeed converging. Markets are asking the Europeans to work better together and to work together in a coordinated manner. I hope that message is well understood.

What we need now, is a combined effort. What we need now is to work together, Member States and the European institutions, to achieve our objectives. I am sure that the work carried out by the task force led by the President of the European Council will give a significant contribution to this goal.

Ladies and gentlemen,

The European economy, the euro area in particular, is under the world's spotlight. Some look at us with a critical, if not cynical, eye. But most look to Europe with admiration and all rational decision makers understand the need of Europe to succeed. We should not shy away from this fantastic achievement of Europe: the creation of the euro. Encouraged by this success, we should now address decisively the challenges we have in front of us and I am more than confident that we will succeed!

Thank you for your attention.