



# ECFIN Economic Brief

## Strategies for a post-crisis world: enhancing European growth Keynote speeches at the Brussels Economic Forum 2010



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The 11th Brussels Economic Forum, held on 25-26 May 2010, took place against a background of the Greek debt crisis and keen debate on the future of Europe's economic governance. In that sense it took place at the ideal moment. Participants debated the causes and consequences of the crisis, and the best way to spur economic growth in Europe, including on how to make growth greener and more sustainable.

This special edition of DG ECFIN's Economic Brief series reproduces the keynote speeches from the conference.

Economic and Monetary Affairs Commissioner **Olli Rehn** opened proceedings by defining the dual challenge of consolidating fiscal positions while laying the foundations for sustainable, smart and inclusive economic growth. European Council President **Herman Van Rompuy** went on to draw some lessons from the crisis for economic policy-making as well as in terms of its political impact. Spanish Finance Minister and Ecofin Council President **Elena Salgado** examined the prospect for strengthened economic governance and looked at the financial reforms that are now under way in response to the turmoil. Commission President **José Manuel Barroso** posed the question: How has the world changed since the onset of the crisis?

and discussed how the EU needs to respond to the changed global context.

Climate Action Commissioner **Connie Hedegaard** argued that Europe should see the crisis as an opportunity to maintain its position as a world leader in green technologies, by making smart investments in infrastructure and pursuing policies that support the creation of green jobs. The smart, sustainable and inclusive growth advocated in the Europe 2020 strategy is within reach given sufficient political will and the right funding environment.

Bocconi University President **Mario Monti** took the floor in the last session to launch the debate on how to build Europe's economic future, calling for more conviction from political leaders in taking economic integration forward and completing the single market – the pillar on which European integration is built. And finally **Olli Rehn** closed the conference, summing up the lively debates of the preceding two days.

The conclusion of the conference was unmistakable: Europe is at a crossroads, and much more is needed to consolidate recovery and put Europe back on a sustainable growth path. I hope you will find this collection of speeches a thought-provoking contribution to how that should best be done. ●



# SESSION I

COPING WITH THE CRISIS

HOW HAS THE WORLD CHANGED?

## EU strategies for a post-crisis world: enhancing growth through smart consolidation and structural reforms



### Olli Rehn

European Commissioner  
for Economic and Monetary Affairs

It is my great pleasure to welcome you to this eleventh edition of the Brussels Economic Forum. Since the Forum was set up in 2000, it has become one of Europe's key platforms for economic policy debate.

I am sure again this year our Forum will provide an excellent opportunity to exchange views among people with extensive experience and intensive insights in economic analysis and policy making. Thus, I am particularly delighted to welcome President Herman van Rompuy, who will in a moment give you the opening keynote address of the forum.

The over-arching theme of this year's forum is "Strategies for a Post-Crisis World: Enhancing European Growth". Some may think this title is hopelessly out of touch of the current crisis mood, as in the long-run – i.e. post-crisis! – we are all famously supposed to be dead.

But let me tell you that the title is indeed a very conscious choice. Please take it as a sign of self-confidence: there will be the long-run, there will be a post-crisis – and we need a concrete vision and bold action to get to the post-crisis world and shape it. That's what this Forum is about.

Let me briefly set the scene for you to the key themes of the Forum.

In the year that has passed since our previous Forum in May last year, we have seen the European economy recover from its deepest recession ever. As our recent spring forecast points out, the economic recovery is now in progress, even though it is still rather modest and fragile.

While massive fiscal stimulus was necessary, the crisis has left us a legacy of high levels of deficits and debt. In combination of speculative short-selling, this has caused turbulence in the sovereign debt markets.

The critical question is whether the real-economic recovery can sustain the renewed financial turbulence. That's what we have recently been working for.

Safeguarding financial stability in the euro area has required exceptional measures, such as the creation of a European Financial Stabilisation Mechanism, a backstop of up to 500 billion euro. But we are not out of the woods yet, and continued vigilance is needed.

Beyond the immediate fire-fighting, we need now to focus on creating foundations for sustainable, smart and inclusive economic growth. In this effort, we face three broad and tough policy challenges:

First, we must get the fiscal exit strategy right. The withdrawal of the counter-cyclical fiscal stimulus needs to be accompanied by substantial fiscal consolidation to reverse the adverse trends in public debt. Recently, several EU Member States, for instance Spain and Portugal, have presented significant new measures of fiscal consolidation.

We should aim at smart consolidation, which calls for a coordinated differentiation among the member states. While accelerated fiscal consolidation is the immediate priority for the countries with no or little fiscal space, others with better fiscal space can maintain less restrictive stances in the short term, for the sake of growth and jobs in Europe.

Second, simultaneously with fiscal consolidation, we have to take structural measures that will lift our potential output growth. In my view, the big risk is that once the recovery gets more robust, we sit idly in self-complacency and forget the structural reforms. That would lead us to a sluggish recovery – or even a lost decade. Sustainable recovery will call for much more than that.

Failing this, our potential output would permanently remain below the path considered possible before the crisis. This is a very real risk, as low investment activity and an increase in structural unemployment have already lowered the growth potential in the coming years.

To address our mid- to-long-term challenges, we need to implement structural reforms that will not only cover the lost ground, but permanently increase our productivity growth and capacity to create jobs.

We have done some simulation, using our macroeconomic model, on the impact of coordinated structural reforms in the EU.

If we can phase in ambitious structural reforms in the coming 5 years, we have potential for an over 2 per cent annual growth rate in the coming decade. That could create over 10 million jobs and take unemployment down to around 3 per cent by the end of the decade.

Meanwhile, with no reforms, Europe would stagnate, with the average output growth at best at around 1.5%, and with a level of unemployment, even after cyclical recovery, at 7-8% at the end of the period.

While subject to the normal uncertainty of long-term projection, the numbers suggest the order of magnitude of the costs of a non-reforming Europe.

The result, in the case of no reforms, would be an over 6% lower level of GDP and 4½% higher level of unemployment at the end of the decade. This would erode the foundations of our social market economy and drain the resources to take care of the people in need of support.

What are the reforms we are talking about? They are nothing new, while the precise content, of course, varies from Member State to Member State. They include making the most of our single market, especially in services; making it attractive for people to move from inactivity to activity and from low-productivity jobs to higher productivity jobs; making the tax and benefit systems more conducive for employment growth; making more focused investments in knowledge and innovation; simplifying the regulatory environment for enterprises to grow, etc.

The issue is not primarily what should be done. It is about the political skill and stamina to build a societal consensus on the necessary reforms.

Thirdly, we must invest in the low-carbon economy and green growth. It is better to be ahead of the curve in striving for a smart and green economic transformation. With the rising trend in global demand for fossil fuels, this is very much in the enlightened self-interest of Europe.

In my view we can meet these challenges only by making a step change in our economic policies. Marginal adjustments are not enough.

The Commission has launched the Europe 2020 strategy to modernise the European model of social market economy and to achieve sustainable growth. It was endorsed by the European Council in March.

To succeed with this strategy, we need to introduce a truly European dimension to economic policy-making in Europe.

This is why the Commission recently presented an ambitious set of proposals to reinforce economic governance in Europe. We want to strengthen preventive budgetary surveillance, to address macroeconomic imbalances and to set up a permanent and robust framework for crisis management. I am glad the Commission's proposals received broad support in the Task Force that President van Rompuy is leading.

In the E.M.U., it is indeed the high time to fill the E with life!

Ladies and Gentlemen,

I am certain that, based on these strategic choices and effective EU coordination, a virtuous circle of sustainable growth, healthy public finances and a return to high employment is within our reach.

Open and substantive debate can do a lot to facilitate these goals. I look forward to such a debate over the next two days.

Your contributions during this Forum will be highly appreciated, as they certainly will help shape our strategies for a Post-Crisis World. ●

## Lessons from a crisis



### Herman Van Rompuy

President of the European Council

In September 1929, a New York investment firm placed an advertisement to attract savings. It briefly told the history of the Mississippi Bubble – wild speculation in the early 18th century – and then said:

"Today, it is inexcusable to buy a 'bubble' – inexcusable because unnecessary. For today every investor has at his disposal facilities for obtaining the facts." These facts would substitute the "sound principles of investment" for the "hazards of speculation", so said the ad.

The men and women who believed this and rushed in to invest their savings – they were disappointed quickly, just one month later, by the great October 1929 stock market crash. It is a pleasure and an honour to give the opening address of this 2010 edition of the Brussels Economic Forum. Judging by the programme, it looks like you are going to have a very stimulating day and a half.

Some of you may recognise the advertisement I just referred to. One finds it in the recent book by Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (2009). The book is widely acclaimed and rightly so. The title is ironic, of course. The author's central claim is that the risk of financial crises has been systematically underestimated throughout history, until today. Every generation of economists and policy makers believes it has ended the cycle of boom and bust. The reasons and words may vary, from "today we have the facts" (in 1929), to "now we have securitised debt" (in 2007). But the refrain is the same: "This time is different".

Every generation believes that. And, well... more than one generation has been disappointed in this belief. The book surely makes for sobering reading.

Why do I mention it? Because it helps us to put things into perspective. In the light of this long history of financial follies, one can "de-dramatise" today's discussion on the public debt crisis.

Accidentally, the recent events have put into question the very title of this conference: "strategies for a post-crisis world"... That looks a bit optimistic today. Are we already after the crisis? Maybe not. Or not yet. I prefer to speak about the "post-recession". By all means, the timing of today's and tomorrow's Forum is apt: after a tense period, culminating in the weekend of 7 to 9 May, the European Union has bought itself time. Time for reflection and time for action. Let us use it well – politicians, economists – all of us.

Before we are "post-crisis", we need to get there. Therefore I should like today to share some thoughts on the current crisis of public debt. I will do so in three points.

- Firstly: how did the European Union deal with this crisis?
- Second issue: what lessons should we draw from this crisis, in terms of economic policy?
- Third issue: what lessons should we draw, in general political terms? What does it mean for the state of European integration?

A final preliminary remark. We are gathered here at an economic forum. So I could talk balance of payments, and balance of trade, and structural growth. However, in front of such a distinguished audience of experts, this could be inappropriate.

As the saying goes: "You don't serve pasta to the Italians"...! I do abstain from serving "pasta" with a little regret, though. As you may know, I am an economist by training; my first jobs were at the Belgian Central Bank and teaching economics at the university. Then, however, I went into politics. To

continue the cooking metaphor, I left the pasta for "sausage making"... (For those of you unfamiliar with the image, it was Bismarck who once said: "Laws are like sausages, it is better not to see them made.")

Let's get to the first issue: how did the European Union deal with the crisis? I should like to focus on the facts, not to the perception. In my judgment the EU did reasonably well. We stumbled, but we did not fall.

The EU works under a lot of political constraints. These are often underestimated by outside observers. In any political system, there is a difference between coming up with a plan, and getting it adopted by a parliament and accepted by the public. (Just think of the American health care plan!) In the European Union, the difficulty is even bigger. We are not a single state. In the case of the euro zone, we are dealing with 16 governments and 16 parliaments, with very different public opinions.

Moreover, at the start of the Greek crisis, we did not have the instruments. The Treaties don't provide instruments to deal with a debt crisis. The founders of the Economic and Monetary Union were convinced that the Stability and Growth Pact would suffice to keep budget deficits low. The implementation was deficient. Member States gave the wrong signal in 2005 when they softened the Pact. Economic growth and the absence of significant "spreads" worked as a drug. Notwithstanding the absence of instruments, we were able to develop them. We built a lifeboat at sea. Anybody who ever tried knows this is not easy!

From the start, the European Council had a double guideline: responsibility and solidarity. These were the two guiding principles to which all Heads of State and Government of the euro zone subscribed. Responsibility, by the Greek government. Solidarity, by the others, in order to protect Greece (and indirectly themselves).

I also stress that, during the process, we kept all our commitments towards Greece. Let me recall the facts:

- In February, we agreed on the principle to take action to safeguard the euro's stability and to help Greece.
- In March, we agreed on the mechanism.

- It was only in April, on the 23rd, that Greece for the first time asked for support.

- A week later, on 2 May, a deal was reached, and one week later, on 7 May, the support mechanism was effectively triggered.

All along, the European Union did what it promised, and when it was needed.

Now, in the final stage, between 2 and 7 May, we were no longer just talking about Greece, but about the risk of contagion to other countries. It was a very serious threat to the stability of the euro and the financial system. That's why we decided, in a special meeting of the Heads of State and Government from the euro zone on 7 May, to use "the full range of means available" to protect the euro. These were no empty words. During the following 48 hours, all institutions and Member States assumed their responsibility:

- The Commission rapidly made a proposal;
- The finance ministers agreed on an impressive safety mechanism for the euro zone – the 750 billion euro package – before the opening of the Asian markets;
- The Central Bank, independently, changed its policy with regard to sovereign bonds;
- Two Member States immediately announced extra cuts to reduce their deficits.

One should consider these actions as one common European effort. Taken as a whole, they clearly show the Union is able to act. To act decisively. I think this was widely recognised. Still, one hears critical assessments. For instance, the EU was only able to act when confronted with imminent collapse. Or, the EU only bought time.

Listening to some commentators, one gets the impression we are living through the biggest crisis since the Second World War, or even the First. Last week, one observer urged European leaders to use the Churchillian language of "blood, toil, tears and sweat" in order to convey a sense of urgency. Well, it is not exactly the outbreak of the Second World War... We are not in a monetary Armageddon. Verbal inflation will not bring back confidence. It is a political duty to keep a sense of proportion. We are certainly in a critical moment; one can call it "unprecedented" and "historical". But crises are always unprecedented, that is the whole point. Therefore I am glad that the

EU has been able to deal with this one. It took time, the coordination was difficult, but it is the result that counts.

Another line of critique dismisses the safety mechanism for the euro as “only buying time”. This disdain is odd. In economic thinking, time is a cost. But not so in politics! In politics, like in human life in general, time is the most precious good. Politicians try to shape it, in order to get things done. Every radical change, such as Greece is now embarking upon, requires time and respite; a temporary protection from the pressure of events, in order to better face them afterwards. The Union has now created this breathing space, which did not exist before. The safety mechanism gives the Greeks time to put the house in order. Therefore the loans are conditional. Conditionality is key in this matter. I am confident they will surmount this crisis.

It is not only the Greeks who must use this time. So should the Union as a whole. As President of the European Council, I urge all actors to focus now on the steps ahead. I just said that during the crisis, we stumbled, but did not fall. In the circumstances, that was not bad. However, we have now reached the point where stumbling itself could be dangerous. I think we are all aware of that. Therefore we need prudence as much as “courage”. The next steps will determine the fate of our Economic and Monetary Union.

This brings me to the second issue of my talk: What lessons should we draw from this crisis, in terms of economic policy? Quite clearly, the key priorities are fiscal sustainability, avoiding public debt spinning out of control, and being able to deal more effectively with financial trouble. Simply put, our two main missions are improving crisis prevention and crisis management. In fact, these are the two subjects of the Task Force on Economic Governance which the European Council has asked me to chair. I should like to take this opportunity to briefly comment upon it. This will give you the state of play on the issue.

The Task Force consists of representatives of all 27 Member States – mostly Ministers of Finance – plus Commissioner Rehn from the Commission, President Trichet from the Central Bank and Prime Minister Juncker from the Eurogroup, and myself as chairman. All key actors are around the table.

Last Friday we had our first meeting. I could feel a sense of urgency and a spirit of cooperation. Everyone shared the will to go forward together. I was impressed how quickly the state of thinking has evolved on the issue of public debt in a few weeks, not just in Brussels but also in the capitals. We hope to conclude a comprehensive agreement in October. In view of our fundamental and far-reaching purpose, that shows a certain ambition.

We already found agreement on the four main objectives.

Firstly, we should reach greater budgetary discipline. All agreed on the need to strengthen the Stability and Growth Pact. A lot of proposals are on the table. They concern both the preventive and the corrective side of the Pact. I will not go into the details here, but they include stronger warning procedures and new types of sanctions.

In the context of a stronger Stability Pact, one aspect may be of particular interest to you, as economists. So far, the focus has been almost exclusively on the maximum public annual deficit, the famous 3 percent of GDP. Much less attention has been paid to the level of public debt (the famous 60 percent). Public debt in the euro zone is now 85 pct on average. It is as if we were looking at Member States’ fiscal positions through the keyhole of the annual deficit, forgetting the bay window of public debt. This needs to be corrected.

I add another remark. The Keynesian approach during the recession of 2008-2009 became in countries all over the world an excuse not to attach sufficient attention to sustainable public finances. As Belgian prime minister, I was rather cautious. In 2010, Belgium will have the lowest budget deficit in Western Europe.

The second objective is a reduction of the divergences in competitiveness between the Member States. This is vital, especially for the euro area. The Stability Pact remains the corner stone of European economic policy coordination. However, sound budgetary policies are necessary but not sufficient to ensure competitiveness. We could have known this from the start, but it took this crisis to hammer down the point.

Over the years, competitiveness in some Member States has improved thanks to wage moderation

and productivity improvement. Others have accumulated important losses of competitiveness and balance of payments deficits on the current account. If one had taken a close look at the figures of these current accounts, the problems of some countries could have been predicted. But this was not a "Maastricht" criterion.

These imbalances are a particular problem for members of the euro area. Their loss of competitiveness can easily be covered – until it is too late. Countries can no longer devalue, but keep advantage of low interest rates. In this respect, membership of the euro zone acted as a "sleeping pill" for some economies. Nobody wants a "rude awakening" by the market forces. One idea therefore is to develop indicators of competitiveness. They should function as an early warning, a wake-up call. Some have proposed to go further, with corrective measures for those who do not act when the red light flashes.

Now, going from crisis prevention to crisis management, I come to the third and fourth objectives on which our Task Force broadly agrees.

Third objective: we need to have an effective crisis mechanism in order to be able to deal with problems such as those of today in the euro zone. The general crisis mechanism that was put into place two weeks ago (i.e. the 750 billion euro package), will function for three years. The question is whether, and if so under what conditions, it should be developed into a permanent fixture of the system.

Fourth objective: we need to strengthen the institutional cooperation and coordination, in order to be able to act quicker and more efficiently when problems arise. In the Greek crisis, we did build a lifeboat at sea, but we can clearly not go on improvising like this. Therefore I intend to put proposals on the table of the Task Force for better coordination between the main actors.

These are our four central priorities.

A concluding remark on these economic policy lessons. A quick-witted mind might wonder, if you have perfect crisis prevention, why would you need better crisis management? Would it not be smarter to put all the cards on prevention? I do not think so. Again, crises are essentially unpredictable. Certainly in the world of credit and financing, where credibility

and confidence play key roles. Confidence is about emotions and psychology, just as much as about market value and economics. This should imply some modesty. To quote Rogoff and Reinhart once more: "Economists do not have a terribly good idea of what kind of events shift confidence and how to concretely assess the confidence vulnerability."

In short: if we are serious about a European economic policy, we should do whatever we can to avoid the type of crisis we already know. That is what we did during the credit crisis of 2008-09, when we avoided all the mistakes that were made in the 1930s because we knew them (for instance: this time, unlike then, we stayed away from protectionism, by safeguarding the European internal market). But we should also be able to deal with unforeseen circumstances. Not if, but when they arrive.

I now come to the third and final issue I should like to address. What lessons can we draw from the crisis in political terms? What does it mean for the state of European integration?

It is a huge subject of course, so just some quick remarks. In a way, the old cliché holds: every crisis is an opportunity. It creates a possibility to act. To do things we were unable to do. Today, one can already feel acceleration in the pace of events.

But here again, a sense of proportion is in order. I do not belong to those who are cheering with a European flag and who are almost thanking the markets for obliging the European Union to take a step forward on political integration. European integration is not a goal in itself. I would rather not have had this crisis, and I am sure the Greek people and most taxpayers in the Union would agree. However, now that we are at this juncture, as a Union, it would be irresponsible not to draw the right lessons. That is what the work of the Task Force is about.

Beyond the specific rules, however, we are clearly confronted with a tension within the system, the infamous dilemma of being a monetary union and not a fully fledged economic and political union. This tension has been there since the single currency was created. It was known to the diplomats and to the experts; it proved ammunition to the euro's critics.

However, the general public was not really made aware of it (at least not by those responsible). The dilemma remained invisible. Nobody ever told the proverbial man in the street that sharing a single currency was not just about making peoples' lives easier when doing business or travelling abroad, but also about being directly affected by economic developments in the neighbouring countries. That being in the "euro zone" means, monetarily speaking, being part of one "euro land".

Today, people are discovering what a "common destiny" in monetary matters means. They are discovering that the euro affects their pensions, savings, and jobs, their very daily life. It hurts. In my view, this growing public awareness is a major political development. It forces the governments to act.

What will they do? We will take those steps towards stronger economic coordination that are currently under discussion in the Task Force. It is necessary and it will be done.

Moving forward will be delicate, because beyond the economics, fundamental political issues are at stake. Take the discussion on public deficits: all Member States want the others to play by the rules, they ask for sanctions, but at the same time they are not per se willing to have "Brussels" look any time into their books...

I expect the steps forward to allow us to better deal with the fundamental dilemma, but not to eliminate it. Getting rid of it would require some federal jump, in which the centre would take precedence over the parts; that is not going to happen. Instead, Europe will stay in the realm of squaring the circle, between the Union and the Member States – but no doubt at a higher level!

In this respect, the European Council has an important role to play. Alongside the Commission and the Central Bank, it is responsible for the Union's economic governance. As the body where the Heads of State and Government of the Member States gather to deal with common European issues, it is particularly capable of squaring this circle. It can assume responsibility for European decisions in front of national parliaments and public opinions, not at a technical level, but at a political one.

In the first proposals on the table of the Task Force, one sees other attempts to square the circle. Take the German idea to integrate the European deficit and debt rules into national legislation: it is a way of making visible that European rules are not just "from Brussels" – and therefore easy scapegoats – but that they are self-imposed by each Member State to the benefit of all. The same is true of the suggestion to hold national finance ministers accountable in their own national parliaments for the examination of the stability programmes of their euro zone partners. This may have disadvantages, but it would make visible that within the euro zone, economic and fiscal policies of the partners are not just a matter of foreign affairs and old style financial diplomacy, but that they are, in a way, domestic affairs. These are encouraging shifts.

Let me conclude with the most important point. It brings us beyond the crisis, back to the main issue of your Forum. The point is quite simply this: we cannot solve our budgetary problems without more structural economic growth. Without growth, we risk a negative spiral. In the short term, the acceleration of fiscal consolidation will hamper growth in the euro zone as a whole only marginally. I am even convinced that lower deficits will enhance consumer confidence and stimulate economic growth.

Moreover, the EU 2020 strategy remains absolutely important. The fiscal strategy has to prioritise R&D, innovation and education. They are key for the future, for increasing competitiveness.

Therefore political leaders will be confronted with a reform programme in the budgetary field as in the socio-economic domains. All this will not be easy to achieve, but it is vital. The European Union and all Member States still have a long road ahead, but I am confident that all have the political will to do what needs to be done. ●

## The unfolding of the global financial and economic crisis: causes, channels of contagion, and consequences. Lessons for the future of the financial system.



### Elena Salgado

Second Deputy Prime Minister  
and Minister of Economy and Finance, Spain

Thank you for giving me the opportunity to share with you some ideas about the challenges we are facing in the economy and thank you also to all the speakers for their interesting remarks. As President of the Ecofin Council I would like to highlight some of the work we are doing to address these global economic challenges at the European level. The Ecofin Council together with the European Parliament is working on a strategy to lay the foundations for a solid recovery. This strategy should also have a preventive component so that a crisis of this magnitude will not be repeated in the future. During the last 2 years we have witnessed a dramatic change in the world economy, but let me start out by saying that better coordination has been critical to mitigating the effects of the crisis. It will be equally important for economic recovery and in particular to foster a strong sustainable and balanced growth. From the beginning of this crisis, the resolute and coordinated action of the economic authorities has prevented both the collapse of the financial markets and an even more pronounced depression of the real economy, and then the subsequent social cost of increased unemployment and poverty. However the necessary exit strategy from these support measures is the biggest challenge ahead. The resulting high level of public debt could lead to unsustainable public finances and hamper the nascent recovery. This crisis has showed the failure of the global financial system to properly assess and manage the risk associated with greater financial integration. Furthermore the crisis has also revealed inefficiencies and weaknesses in other markets, products, labels and other resources as well as the risks of permitting global imbalances to progress. We have to work together in order to restore the confidence in our economic system.

To do so, we have to implement a number of reforms in a coordinated and transparent way. Confidence

in markets, economic policies and public finances is essential to strengthen the economic recovery and future growth. Let me first start with confidence in public finances and hence fiscal consolidation to set the house in order as has been said today here. Sustainable growth needs a credible fiscal consolidation strategy. The support measures to mitigate the negative effects of the recession together with a drop in economic activity have had a large budgetary impact. The result has been the creation of large fiscal deficits and significant increase in public debts levels throughout most of Europe. Even if in some countries at the beginning of the crisis, the margin of manoeuvre was considerable. So in the short term a credible fiscal consolidation strategy has to be strong enough to stabilise the rising debt to GDP ratio underpinning the sustainability of government debt, but in the medium term, it must also imply bringing down debt ratios to sustainable levels consistent with future growth. As we have witnessed in the Greek crisis, the lack of credibility in the sustainability of public finances has led to increasing pressures in sovereign debt markets not only in Greece but also in other euro-area members, deteriorating significantly the borrowing conditions. The coordinated action between the euro-area Member States, the Commission, the ECB and the IMF to deliver a support package for Greece has had as you know a relatively short relieving impact on the markets. Investors have remained reluctant to fully trust the real capacity of some governments to implement consolidation plans in the medium term. The markets do not fully distinguish the variation in risk from one country to another. As a result the situation in financial markets remains fragile and the European Union has decided to address the risk of contagion by developing a package of measures in order to ensure the financial sustainability of the euro area. The package as you will know includes the

creation of a European financial stabilisation mechanism with the possibility of additional support from the IMF and a strong commitment among Member States to accelerate fiscal consolidation and structural reforms. Only if this fiscal consolidation is credible will the whole package have the desired effect. Moreover a credible fiscal consolidation has to take into account longer term challenges such as the ageing of the population. The pressure on social security systems and expenditure has to be tackled, beginning now. Alongside fiscal consolidation, Member States must also undertake structural reforms that foster productivity gains and pension system sustainability.

Let me highlight again that the crisis has revealed a need to strengthen the EU and euro-area economic governance. At the EU level the Commission has published a Communication and we are working through a taskforce chaired by President Van Rompuy to identify the instruments the EU needs to prevent new imbalances from arising that might create future crises affecting the euro area and the EU.

We are examining how to strengthen the Stability and Growth Pact. The Pact is a good instrument, but it should be improved. The prevention side should be reinforced to guarantee public debt sustainability. Furthermore, we in Europe are examining how we could deal with macroeconomic imbalances, how to detect and how to prevent them. We are also looking at how to improve competitiveness where needed, enhancing European economic surveillance. And finally, with respect to crisis management, we are studying how to create a permanent financial stabilisation mechanism for the euro area to mitigate market turbulence and prevent contagion episodes. But sustainable growth can only be achieved if the financial system is stable and efficient. And this requires an improvement in the quality of financial regulation and supervision together with greater financial integration.

The existing global financial regulatory and supervisory framework has been unable to properly assess and manage risk. Abundant liquidity and excessive risk-taking led to the growth of asset bubbles, imbalances and systemic risk in the international financial system. The revealed existing weaknesses in the global financial system have to be addressed in order to avoid the risk of new

imbalances forming in the future. It is imperative that we return full confidence to financial markets, since this confidence has been very seriously damaged in the financial crisis. Hence we have to complete our regulatory and supervisory reform to convince agents that errors and abuses of the past will not happen again. Thus under the umbrella of the G20, the Financial Stability Board and the IMF, we have committed to create a new system of rules to strengthen international institutions, to improve regulations and to overall reshape the global financial system, making it more efficient but also more resilient. The main areas of reform are strengthening prudential regulations to increase the quantity and quality of regulatory capital, counter-cyclical provisioning, regulation and liquidity and introduction of leverage ratios. At the EU level we are also advancing on the modification of the Capital Requirements Directive with a focus on improving the quality and quantity of capital, identifying and assessing the risks of systemically important financial institutions on the basis of a wide range of factors such as the discussion on resolution funds and systemic levies.

At the EU level, we are working to put in place new European macro- and microprudential supervisory architecture to help address some of these important questions when dealing with systemically financial institutions in Europe. We are also making progress on hedge funds regulation at the global level. As you know, at the EU level we are advancing for the first time ever, European regulation over the management of alternative investment funds, which introduces harmonised regulations including transparency requirements on all investment funds other than UCITS. We have also to think about the realignment of compensation schemes to discourage excessive risk-taking in line with FSB principles for sound compensation practices and its implementation standards to be adopted by G20 members. Derivatives and structure products reform with the main objective of reducing counterparty credit risk, centralising clearing processes and increasing transparency are among our other tasks. We are working at the EU level so that the new regulation on derivatives drafted along these principles is passed during 2010. Let me stress that in the derivatives legislation at the EU level it is crucial that

a global and coordinated approach is taken in order to avoid any disruption of competition. It is also important to encourage the adherence of non-comparative jurisdiction to international regulatory and supervisory standards. The work of the Financial Stability Board (FSB) in response to call of the G20 leaders, the global forum on OECD is crucial to this objective as it is a role of the IMF and the World Bank. And finally we must pursue the conversions of global accounting standards by June 2011. We welcome the anticipated publication by the International Accounting Standards Board (ISAB) by the end of this year of the new International Financial Reporting Standard (IFRS) 9 dealing with financial instruments accounting in line also with FSB recommendations to avoid excessive reliance on fair value accounting. We are conscious that new imbalances can always arise in the future, so our objective is not only to prevent them but should be to decrease their size, their frequency and their consequences, keeping in mind the potential trade-off between stability and growth.

In order to avoid market disruptions and regulatory arbitrage opportunities, implementation of the new global financial regulatory environment must be coordinated closely among national and international institutions to ensure a level playing field. The adaptation of regulation to fit national specificities must remain consistent with the global commitments stated in G20 discussions. But finally, in the longer term we have to make sure that we enhance our growth potential and this is also the goal of the EU 2020 strategy. Thus structural reform in different fields is needed. The aims of the reform must be among others to intensify competition, to improve innovative capacity, to reinforce accessibility of financing for SMEs, to promote human capital formation, and to foster social and economic cohesion in our regions. The recession has exacerbated the imperfection of the labour markets, we have to implement reforms in these markets making them more efficient, more flexible, and more inclusive. The most vulnerable groups which have been the hardest hit by the crisis must gain stability and the current high levels of unemployment resulting from this crisis have to be absorbed back into the labour market. I am convinced that we can take advantage of these coordinated efforts to

complete the financial reform under way in the G20 and the FSB and to improve the coordination of economic policies in the EU in order to underpin future prosperity for the benefit of our citizens. Because I think that it's only by working together that we will reach our goal: A low-carbon and knowledge-based economy that creates high quality jobs and leads to a sustainable, balanced and strong growth. ●

## Keynote address



### José Manuel Barroso

President of the European Commission

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 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 cooperation.

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 manage to contain the second reflex, it will have been 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 resources 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 than "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 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.

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 proposal 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, since not all Member States are in the 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 and 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.

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 discomfiting. 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 strengthening the Stability and Growth Pact, but also "yes" to reinforcing 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 our Europe 2020 strategy with vigour. 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 their sustainability. And so on and so forth. So I am happy to 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 avoid talking about 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, as 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 simply acted as a wake-up call. I hope this time it will be heard by all of us.

There is no doubt that 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 where 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 uncoordinated 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. ●



## **SESSION II**

**TACKLING GLOBAL WARMING:  
AN OPPORTUNITY FOR EUROPE**

## Keynote address



### Connie Hedegaard

European Commissioner for Climate Action

Good evening. It is a pleasure to be here to speak to you and to bring the first day of this important forum to a close. Let me first of all thank you for your input to this afternoon's session on the potential opportunities of tackling global warming.

I am confident that some of these valuable ideas on the three topics discussed will be key in the debate on strengthening the European Union's leadership in the fight against climate change. They can also feed into tomorrow's session on how Europe exits the financial and economic crisis.

We have been reminded today that: YES we need to tackle this financial and economic crisis, and YES this should be pursued vigorously – it is a top priority. But this should in NO way prevent us from moving ahead on climate change and energy security issues. Rather the contrary. I think that what we have seen unfold in Europe over recent months and the last few years reinforces the case for taking decisions now on structural and long-term measures that will make Europe stronger in the face of the crisis and of the global competition. That will be the first and foremost question when we have handled the immediate crisis and we'll have to look to solutions in front of us.

As Nicholas Stern rightly said about the link between the financial crisis and climate change: if we leave climate change to the coming decades, we will just repeat the mistake that led to the financial crisis.

### The role of green technologies

Instead we need to look for the opportunities for Europe and for synergies between policies. The case for green technologies playing a key role in sustainable economic growth in Europe is compelling. The global market for environmental technologies and products is forecast to grow strongly at around 10% annually over the

coming years. The EU needs to be in a position to take full advantage of this opportunity.

Look at our energy policy: by boosting renewable energy, energy efficiency and carbon capture and storage, Europe is paving the way for the key technologies that will be needed in all regions of the world if we are to make the deep emission cuts that are necessary. We are taking the lead. Implementing our policies will also cut Europe's oil and gas imports, thus increasing energy security and reducing our import bills.

Eco-industries, and eco-innovation more broadly, are no longer a niche. They can be a real driver for growth and jobs. Increasing numbers of companies are making "green, low-carbon and resource-efficient" the basis of their business models. This happens also in traditionally "grey" industries.

One very recent example is an investment (€60 million) launched by a major European steelworks – Corus. They decided to recover gas from the steelmaking plant and reuse it elsewhere in the steelworks. Why? Because it will halve their bill for external gas. And by the way, it will reduce the site's CO<sub>2</sub> emissions by some 240,000 tonnes per year. This steelworks gives work and will continue to give work to 5,000 people on the site and a wide community of contractors, suppliers and other partners.

Business opportunities from tackling climate change reach out beyond industry. I hear many success stories concerning services. A major European retailer – Tesco – has opened a number of low-carbon stores and, last year, the world's first zero carbon supermarket. They say that such investments in reducing emissions are saving them over 100 million euros a year in energy costs.

Environmental industries directly employ around 3.4 million people and account for around 2.2% of Europe's GDP – more than the pharmaceutical or aerospace

industries. Studies show that each direct job in Europe's eco-industries indirectly creates between 1.3 and 1.9 more jobs. These gains can be reaped all over Europe.

## Financing and structural reforms to foster low-carbon growth

Europe gave itself a head start on the road to building the low-carbon economy when our leaders set the 20-20-20 targets and the climate and energy package was subsequently agreed at the end of 2008.

But since then, the economic and financial crisis has accelerated the pace of the low-carbon transition. And today the other major economies have also recognised the opportunity and are moving to take full advantage of it. There were definitely things that we did not achieve in Copenhagen, but actually one very important European priority we did achieve was that for the first time ever we got the four major emerging economies internationally to accept that without their contributions in the longer term we will not be able to cope with the challenge.

Governments in many countries have used national stimulus packages to give a major boost to green infrastructure, low-carbon energy production, smart electricity grids and clean energy-related research and development.

China is undertaking the largest green investment programme of all, totalling around 230 billion US dollars. The US will invest over 80 billion dollars in clean energy. But the EU and the bigger Member States are investing only about 25 billion euros because public budgets are under pressure.

The reality is that global competition for green growth and jobs is getting fiercer.

Europe no longer leads on renewable energy when it comes to the installation of new capacity. The 2010 Renewable Energy Attractiveness Index cites US and China as the best investment opportunities for renewables.

The US is aiming to double its renewable energy generation by 2012. Last year China topped the global league table for wind power installation. Chinese and Indian wind turbine manufacturers now appear in the top ten. China and Taiwan now produce most of the world's photovoltaic panels. These industries are rapidly

becoming global players. If we stand still, we will lose our frontrunner status.

My ambition is to see Europe become the most climate-friendly region in the world. This is in our own interest, because it will solidify our position in the expanding market for clean technologies.

My own country, Denmark, provides a very convincing business case for this. In the 1970s we relied almost exclusively on imported oil. And as a consequence the oil crises literally pulled the plug on our economy.

In order to tackle the crisis, Denmark established policies to limit our energy consumption and spur renewable energy production – using taxation, fiscal subsidies and public funding for research and development.

Furthermore, comprehensive district heating systems were established in all cities and communities supplied by highly efficient combined heat and power plants. And waste incineration was introduced for power and heat production. Today, in Denmark, we turn all of our household waste into energy.

And these initiatives did not harm the economy. On the contrary: since 1980, Denmark's economy has grown by 78 percent with nearly stable energy consumption. And today, Denmark has market leaders with a number of clean tech industries, wind, pumps, waste handling, combined heat and power – just to mention a few.

Last week I hosted a round-table meeting with leading European business leaders. One of the clear messages I received was that EU countries have the potential to become world leaders in a range of low-carbon areas, including offshore wind, smart grids, electric vehicles, biomass, waste and energy-efficient buildings.

We must realise this potential. We cannot miss this opportunity. And that means creating the right framework conditions for innovative businesses to thrive.

Of course we need policies that take account of the pressure on public finances in the aftermath of the financial crisis. This pressure compels us to better focus our limited resources on ambitious policy objectives.

Public spending must focus on areas that are not adequately financed by the private sector and where pooling resources makes sense. The EU budget for example can provide added value by targeting the public goods and market failures that remain out of the reach of national and private investment alone. The bottom line is we must invest more to drive our

innovation and leadership forward or Europe will lag behind.

## Europe 2020 strategy

By making smart investments in infrastructure and pursuing policies that support the creation of green jobs, the EU can develop the low-carbon competitiveness needed to nurture the smart, sustainable and inclusive growth which we advocate in our Europe 2020 strategy.

That is also why European leaders have committed to reducing the European Union's emissions by least 20% of 1990 levels by 2020.

The 20% target was always seen as a critical driver for modernising Europe's economy. But the economic and financial crisis has reduced both greenhouse gas emissions themselves and the cost of cutting them in future. It has also pushed down the carbon price for the foreseeable future. While that is good news for business in the short term, it does not create an incentive to innovate. And for the growth in the post-crisis world, innovation is crucial.

We need to be clear about the implications of these changing circumstances. That is why the Commission is conducting an analysis of the implications of moving to a 30% target, and their costs and benefits, seen from today's perspective.

## Beyond 20%

The Communication setting out our analysis is due to be adopted tomorrow but I would like to give you a brief preview. Let me first stress that this exercise is not about taking a decision now but about presenting a thorough analysis of the implications of a possible move to 30%.

The analysis shows that the economic crisis has made it one third cheaper to achieve the 20% target than estimated two years ago. It does not mean it is easier, but since 2008, the estimated cost has fallen from at least 70 billion euros to 48 billion per year by 2020. This is due to several factors: lower economic growth has reduced the effort needed; higher energy prices have spurred energy efficiency and reduced energy demand; and the carbon price will stay well below the level projected in 2008 as EU ETS allowances not used in the recession are carried forward.

The cost of reaching the 30% target is now estimated at 81 billion euros per year by 2020, 11 billion euros higher than the price tag for the 20% target two years ago. This means that the 30% target would cost €33 billion (0.2% of GDP) more than the 20% target is estimated to cost today, though this does not reflect co-benefits in terms of better air quality worth 6.5 to 11 billion euros a year.

The analysis also shows that the 20% target is not enough to put emissions on track to meet the EU's goal of a 80-95% emissions cut by 2050. There is a risk that achieving the deep emission reductions that will be necessary after 2020 will become more difficult and more expensive. The International Energy Agency has estimated that every year of delayed investment in low-carbon solutions adds 500 billion US dollars to the global price tag.

The technologies necessary to transform the economy exist. Wind power, smart grids, energy-efficient lighting, high efficiency combined cycle power plants, high voltage direct current transmission systems – they are all available from European companies today.

The effects of implementing these technologies are striking. For instance, a city-centre shopping and leisure complex in Britain has cut its energy use by 85% by installing energy efficient LED lighting supplied by a European manufacturer.

The grids are one area where investments in efficiency can bring significant gains. A major European company has some time ago invested in reducing transmission losses and improved energy efficiency. In one year, they achieved energy savings equivalent to the energy necessary for about 20,000 consumers, and cut their costs down significantly.

These technologies need to be deployed on a large scale if we are to seize the opportunity. And one of the essential conditions for this to happen is a well-functioning carbon market that creates the right incentives.

The Communication will set out options for meeting the 30% target. There are several instruments, e.g. reducing the number of auctioned allowances; regulation to promote greater energy efficiency, directing EU cohesion policy funding towards green investments; or improving the environmental integrity of the international carbon credits.

We have also examined the situation of energy-intensive industries with regard to the risk of "carbon leakage". The key conclusion is that the Copenhagen Accord improves the competitive position of these EU industries. Since uncertainties remain over implementation of the Accord, however, the existing measures to prevent carbon leakage from these industries – free allowances and access to international credits – remain justified. Raising the target to 30% would have a limited impact in terms of carbon leakage, provided the existing measures stay in place.

Of course, whether to move to a 30% target is a political decision for EU leaders to take in due course. Our Communication should provide a solid basis for debating this question.

Let me finish by saying, as I have said a few times: nobody believes this is very easy. I just think that we should also consider that we are not as alone in the world as we used to believe, because others have seen

where the markets of the future will be, and this is what must also be part of our equation. This is not sort of a hippie agenda, it's not a zero growth or anti-growth agenda, actually it's the opposite. It is to try to provide a basis for continuing to have growth also in the future, also in those many regions in the world where they haven't had enough growth yet to accommodate the needs of their people. So this is about how best to position Europe, to continue to be the economic front-runner of the world. We managed this in the last century; we must also manage to do so in the 21st century where sustainable growth is and will continue to be the only kind of growth that the planet can afford.

Thank you very much for your attention. ●



## **SESSION III**

**EXITING THE CRISIS:**

**BUILDING THE ECONOMIC FUTURE OF EUROPE**

## Keynote address



### Mario Monti

President, Bocconi University

I am very honoured to participate for the third consecutive year in the Brussels Economic Forum and thank Olli Rehn and Marco Buti for inviting me.

In fact I see a remarkable thematic continuity here. When this event took place two years ago, in 2008, the topic was EMU at 10. I took part in the session on “An ambitious agenda for stronger growth”. I started at that point to convey my concerns, if not dismay, at the idea that EMU, which I always thought to mean Economic and Monetary Union, looked more and more as if it meant Economic or Monetary Union, as if there were a choice for participating countries to decide what part of it they wanted to take seriously, because Member States of the euro zone already at that point did not seem on average to take economic union, the underlying pillar of EMU, very seriously, and I must say the situation has not changed or at least has not changed for the better since. And if we look at the 12 worst offenders in terms of, for example, transposition times of the internal market directives, well, they are Member States belonging to the euro area, and euro-area members feature prominently in the ranking for the number of overdue or incorrectly transposed directives, sometimes even in the area of the single market for financial services that you might have believed to be particularly proximate to monetary integration, therefore particularly close to the heart of Member States – because I assume that Member States do have a heart – belonging to the euro.

Last year I developed some thoughts here on the current and prospective threats to integration in Europe and how perhaps a package approach could allow to make some improvements to that situation and I was particularly delighted to see that in his Political Guidelines last September President Barroso, presenting his programme for his second Commission, clearly indicated the intention that a new political initiative should be launched. I must say the Barroso I Commission

in my view had already done a very remarkable job in fighting emerging economic nationalism by way of determined actions in the area of internal market and competition against economic nationalism. The next necessary step was in my view rightly taken by President Barroso when he announced an initiative to relaunch the single market. And I’m very honoured that as part of that initiative he asked me to contribute some ideas which are in the report submitted to him initially and then transmitted to the other European Institutions two weeks ago.

There are in fact striking similarities between the initiative that President Delors took in May-June 1985 at the beginning of his first Commission and the initiative that President Barroso has announced at the beginning of his second Commission. Of course the European Union of today is enormously more complicated: not only are there 27 Member States rather than 10, but the degree to which for any forward step the consensus of civil society and stakeholders is needed is much greater today than it was 25 years ago. That is why President Barroso suggested – and I trust I diligently followed that suggestion – that in order to prepare the report I should hold a very extensive consultation, involving the European Parliament, the Council and the governments of Member States, but also civil society and stakeholders, on how to move forward towards deeper economic integration and a more perfect and resilient single market.

Since President Barroso launched that initiative, two new circumstances occurred, which lend additional importance to the initiative. These two circumstances figure as key topics in this edition of the Brussels Economic Forum. They are nothing less than the crisis of the euro and the fiscal crisis of most Member States.

What is the link between the state of the underlying economic integration, particularly of the single market, on one hand and these two emerging phenomena?

Panel 1 this morning will discuss the topic of "Policy coordination in the euro area – lessons from the crisis". To me, one of the lessons from the crisis if we look at the country where the crisis originated, Greece, is that the weaknesses in monetary union exposed by the Greek crisis have their immediate manifestations in the reactions of financial markets to public finance disequilibria. However if we look at the underlying causes of such disequilibria one of them is certainly the inadequate competitiveness of the real economy and yesterday morning we heard President Van Rompuy stress how much in his task force the attention will be given to movements in competitiveness as an early warning of problems. In turn, the inadequate competitiveness of the real economy is largely due to the fact that corporatism, one could say "clientelism", and rent-seeking in both the public and private sectors still keep the domestic economy partly sheltered from the full play of the single market and competition, thus preventing the needed improvements in overall productivity. This situation is by no means exclusive to Greece and calls for more single market – just think of what a difference it makes whether or not public procurement provisions are taken seriously, in terms of the competitive impulse you give to the economy and also in terms of cost-saving for the budget.

The second circumstance under our eyes that lends additional importance to the single market and economic union has to do with the whole of the EU, not just the euro zone. Panel 2 will discuss the topic "Ensuring Europe's economic future – ways of raising Europe's growth potential". Well, probably no one considers today that there might be room for economic growth in Europe coming from fiscal stimuli, given the very serious fiscal crisis in most Member States. There are not many available sources of potential and actual growth in the European economy. I find an increasing consensus on the notion that a big potential still, not yet fully exploited fully, is precisely the one deriving from a better structural organisation of the European economy, which should to a large extent derive from much deeper economic integration and a much smoother economic union.

Thus, these are two solid reasons – in addition to the purism of those, like myself, who want to see more

integration almost as an end in itself – why going ahead seriously with the single market is more important than ever. The problem is that it is also more difficult than ever because it is rather well known – and certainly my consultation confirmed that very clearly – that the single market, although being more needed than ever, is today more unpopular than ever. And it is important in my view politically not to neglect this and not to proceed as if this were not the case. I think it is very sound to proceed as the Commission does in terms of bottlenecks and missing links. What is missing, let's try to fill in. But I think even more important is to go slightly deeper and examine what the concerns are about the single market and I believe that the concerns are huge, and widespread, though they are not evenly distributed across stakeholders or across Member States.

In my view, the only concerns that we find about which we should almost be happy, and indeed should do nothing to reduce, are the concerns of rent-seekers because of course they are going to suffer as the single market and competition make progress. But all the other concerns, be they of a social nature, of an environmental nature, of a business nature – because one of the new facts of the last few years is that business, and big business in particular, no longer seems to be almost theologically united behind the objective of a single market – do need to be taken seriously. But it should be possible to address such concerns in ways that do not lead to undermining progress in the single market, quite the opposite. But we need to be aware that some rather extraordinary political approach is needed. There have been many reports in the past on how to complete the single market. What is at stake today, I believe, is much more than the issue of "completion". We need to find a strategy on how to go ahead with the single market even though we move to a situation in which in many Member States there is an emergence of political parties on the right and on the left which are united only by the element of rejecting integration, be it global or European. We need to get ready for this by addressing those concerns which, if left unaddressed, can only nurture further reluctance to integration. So I think what is needed is a three-pronged approach: initiatives to build a stronger single market (because one could say: OK, the single market is unpopular, let's try to preserve it by not making it too unpopular, i.e. by diluting enforcement, by making it softer: I think this would be the wrong way to go); initiatives to build

consensus on a stronger single market; and initiatives to deliver concretely a stronger single market.

The initiatives to create consensus on a stronger single market need not be big concessions that would undermine the economic value of the single market, but they can be focused. For example, the report identifies ways to achieve a conciliation between economic freedoms in the single market and workers' rights, following the Viking, Laval and other rulings of the Court. The report presents many proposals as regards the place of social services in the single market, the integration of broader EU policy goals in public procurement policy, how to use tax coordination to safeguard national tax sovereignty as market integration proceeds, the balancing of competitiveness and cohesion within the single market and other lines of action to address the concerns.

Let me conclude with a slightly more institutional or political observation. I worked for 10 years on the single market as Internal Market Commissioner and then as Competition Commissioner. One big underlying problem is that the single market is a grey topic, boring topic. It must be said that it's very generous for people like ECFIN who handle what is politically perceived as a very important topic to give 20 minutes to a grey topic like the single market in this conference. It's a topic which is seldom perceived in a holistic manner because it is a boring set of thousands of directives and minutiae which interest all the stakeholders around Europe and have huge implications but are seldom seen as a cohesive entity. So if there is a topic which is not sexy in European integration, that is the single market. The problem is that it is the topic which is the pillar on which all the rest rests.

And so I make at the end of the report some proposals on one hand how to refocus the EU institutions, all three of them, Commission, Parliament and Council, on the single market, but also on the place of the single market in EU policy-making. For example, right now there are 3 policy areas which rightly command the attention: Europe 2020, EMU, and of course the emerging economic government issue. And the single market can easily be totally absent from these, yet can easily be proved to be the pillar of each at the same time. Take Europe 2020, which is, in my view, an admirable overarching architecture. Where will the political energy come from to deliver it? I think it will have to come largely from a deal between various clusters of countries, the social

market economy countries, the Anglo-Saxon countries, the new Member States, recreating some conviction and enthusiasm for economic integration and the single market. I already mentioned EMU, and as regards economic government I think many key players, from the German Chancellor to, as I understand it, the President of the European Council, are looking – now that economic government is an accepted currency in principle – for topics of significance that would lend themselves to be treated at 27, not to be confined to subsets like the Eurogroup. And of course the single market is a topic which should for example keep the UK firmly on board and as a key actor particularly now that they discovered, and everybody else rightly discovers that the single market 25 years ago was – yes – the product of Jacques Delors, but very much also of a conservative British government in the name of Margaret Thatcher and Lord Cockfield. And the very last note that I will make in this context is now that the European Council also through the role of its permanent President can afford greater continuity in steering the economic governance of the EU, it would be very helpful in my view to have a top-level comprehensive guidance of the Council's contribution to this key pillar of the European integration that is the single market. Because now there is the Competitiveness Council, there is the Ecofin Council for financial services and tax policy, there are other Councils, but honestly no cohesive view at all. So there is no political ownership for what remains probably the most important project of the European Union. So the idea is while the power of initiative and enforcement under the control of the court will of course have to remain firmly in the hands of the Commission, the whole process of giving a stronger impulse to the single market, for example to achieve a European patent in slightly less than 3 decades, would benefit if the European Council considered this to be one of its key areas of permanent attention, giving its President a mandate to ensure that is done with political vision and concrete continuity in close cooperation with the President of the Commission. And perhaps the Parliament, the Council and the European Commission could once a year have a state of the union event (in the sense of state of economic union), taking stock of where economic integration is going and also to watch out for signs, before it is too late, of whether economic integration might be turning into economic disintegration.

## Closing address



### Olli Rehn

European Commissioner  
for Economic and Monetary Affairs

Ladies and Gentlemen,

We have an intensive day and a half of economic policy discussion behind us. The Brussels Economic Forum has once again shown its value as a way to bring together policy-makers, senior civil servants, academics and other experts of economic policy issues.

Let me thank all the speakers and organisers for making this a very stimulating and interesting conference. The central theme of the Forum, mapping strategies for a post-crisis world, has been approached from many angles. I won't try to summarise the great variety of viewpoints presented in the conference. Instead, let me try to translate the intellectual input of this two-day think-thank into operational policy conclusions.

The over-arching task now is to ensure that the recovery will not be derailed and that we can adequately address the longer term policy challenges, which calls for determined action on all fronts.

The policy agenda comes as no surprise to any of us having followed the discussion in this conference. We need to:

- get on with a rapid but smart process of consolidation,
- put life into our long-term structural growth agenda, Europe 2020, including the measures on green growth,
- complete the reform of financial regulation and supervision and,
- improve economic governance on a broad basis.

### Consolidation

The debt burdens that have been and are being cumulated call for a stronger approach on fiscal consolidation than pursued so far. This concerns basically all EU member states. However, there is also a clear need for differentiation. The most indebted

countries and who have turned out to be most vulnerable to market reactions need to take speediest and strongest measures. This is in fact happening. This also needs to continue. The countries that have more fiscal room of manoeuvre can take a more gradual approach to consolidation.

When considering consolidation measures, it is essential to keep in mind their effects on growth. Some types of expenditure are more growth-friendly than others; some taxes more harmful than others. Here economic analysis provides important guidance. Expenditure on key infrastructure, education (particularly at the early stage), and research and innovation activities support growth. Corporate income taxes and taxes on labour harm growth. Smart consolidation therefore implies important choices. But clearly fiscal consolidation alone is not enough.

### Growth

The second task is to lift our growth potential. Given the constraints on public spending, potential growth cannot be lifted by throwing more money at the perceived bottlenecks. It is simply wrong to think that promoting growth equals more public spending. There are areas where growth promotion is not primarily – if at all – a matter of higher public spending. Instead, the key task is to allocate the available resources efficiently and to make the most of the current resources for investment. We also need to improve the general framework conditions for higher productivity and employment creation.

As has been noted in this conference many times, we need structural reforms more than ever. This concerns all scenes of economic activity: the product and service markets; labour markets; financial markets; and the provision of public services, including social security. Especially, we have to make the most of our 500 million

people internal market. A balanced re-launch of the single market programme, which was so well presented today by Mario Monti, is central. The completion of the single market agenda is in my view the least costly way to boost growth in Europe.

It is also obvious that the fast-advancing digital technology still provides huge possibilities for productivity growth. In particular many public services can be much more efficiently produced by creatively applying modern digital technologies. This requires substantial adjustment in the way services are organised, which can lead to equally important savings.

Moreover, Europe has been on the forefront in developing green, resource-efficient technologies, but risks losing that lead. While we cannot base our success in this area either on increased overall spending, we can allocate the funds for research and subsidies more effectively and efficiently. One particularly important thing is to create large enough markets for innovative European products and processes through common standards and forward-looking government procurement policy.

## Financial reform

We must soon complete our ambitious agenda of reforming financial regulation and supervision. Our priority here is to have the legislation ready for the European System of Financial Supervisors (ESFS) and the European Systemic Risk Board (ESRB) to start at the beginning of 2011.

As far as financial regulation and the resolution mechanisms for banking crisis are concerned (including the participation of the financial sector in costs of resolution), we need global solutions. That is why Europe must speak with one clear voice in the international arena, particularly in G20.

## Governance

The same goes for policy coordination in general. We need to strengthen the existing rules-based mechanisms to prevent fiscal profligacy of individual member states harming the others. We need to better tune the overall

fiscal policy stance to the needs of the euro area and the Union as a whole.

The Commission's proposals are on the table, and I'm glad to see that they have received wide support, I would say such support that was hard to imagine just a few months ago. There seems to be one silver lining in the crisis: it has made it absolutely clear to everyone that coordinated policy-making is a necessary condition for economic and financial stability in the increasingly integrated European Union.

Ladies and gentlemen,

I'm equally encouraged by the discussions in this Forum. There is a wide recognition that fiscal consolidation is necessary, which must be accompanied by structural reforms to lift our potential growth. By recognition I don't mean just an expert opinion. I think that what has been said here also reflects broader understanding among the decision-makers and citizens that we have to change our ways.

We do indeed have formidable challenges ahead of us. But I'm convinced that we also have the means and the will to meet them. Joint European action will be the key factor in achieving that, not least since we are at a crossroads today. Either we take determined and joint action for Europe's economic and political revival – or we risk economic stagnation and political irrelevance. ●