Vice-President Olli REHN in Dublin 25.2.2013 SEMIFINAL

The future evolution of the Economic and Monetary Union

Honourable Minister, Members of Parliament,

Ladies and Gentlemen,

Thank you for the invitation to this meeting of chairpersons of Finance Committees. The theme of this discussion is to look forward. However, seeing this meeting is taking place here in Ireland, I first of all want to underline the great efforts that have been taken in this country throughout the crisis. Thanks to the unforeseen measures and dedication of the Irish people, Ireland will in the end of this year be able to exit the programme and fully return to the markets. The hard work has paid off.

Let me give you an overview of where we stand at the moment in the European economy on the basis of the **Winter Economic Forecast,** published by the Commission on Friday. The forecast shows signs of improving sentiments on the financial markets *(pp-slides 1 and 2 on confidence, financial markets and credit conditions)*. Reforms are starting to pay off, the deficits are declining and Europe will gradually return to growth *(pp-slide 3 on GDP).* However, current hard data was disappointing, in particular GDP in the fourth quarter. The recession has deepened at the end of last year. Compared to the previous quarter, GDP shrunk by 0.5% in the EU and 0.6% in the euro area (in Q4 2012).

On this basis, this year we will see overall zero growth of GDP in the EU, although this hides that the quarterly developments are likely to look more dynamic over the course of the year. As the recovery begins to take hold more firmly in 2014, growth in the EU should amount to 1.6%. Inflation is expected to fall below 2% this year and decline further to 1½ % in the next. The major risk to the forecast would be to lower our guard on the necessary reforms to bring back growth and stable jobs.

Europe has made progress with the necessary fiscal consolidation *(pp-slide 4 on public finances).* For 2012, we expect the headline deficit to have declined to 3.8% in the EU and 3.5% in the euro area. In the euro area, this reflects a fiscal consolidation effort of about 1½% of GDP. Given the progress made, on the basis of 2013 budgets we expect further measures of about ¾ % of GDP in the EU and the euro area that should bring the deficit below 3% of GDP this year in the euro area.

The unemployment rate in the EU amounted to 10.5% in the EU and 11.4% on the euro area in 2012 (*pp-slide 5 on unemployment)*. These figures unfortunately mask large differences between Member States.

This reflects the large adjustment challenges that some Member States are still facing – despite the significant progress made. The rebalancing process after the credit-fuelled boom has progressed, but we should be clear that it will continue to weigh considerably on growth and public finances for some time to come, especially in some countries.

Ladies and Gentlemen,

The forecast makes it clear that the work is not finished yet, we have great challenges ahead of us. The debate on the future of the EMU cannot ne limited to institutional issues, but we must focus on growth, job creation and competitiveness of European industry at least with the same vigour and energy. We face three over-arching challenges.

First, we need to find a solution to the challenge of sustainable growth. Second, we need to continue with on-going efforts to meet the challenge of fiscal sustainability. Third, we have to meet the challenge of rebuilding the Economic and Monetary Union.

The **first challenge, sustainable growth and job creation**, calls for us to reverse the trend of European losses in global competitiveness.

Most of all, Europe needs more entrepreneurs and businesses that are hungry and able to grow. This implies tackling bottlenecks to growth by creating an entrepreneur-friendly business environment with better access to finance and leaner and more efficient business administration.

We need to focus on boosting productive investment – both public and private. Public banks such as the European Investment Bank have an important role to play here. The increase in the EIB's capital and thus lending capacity agreed last year is a very concrete example of this.

At the same time, we must not forget that <u>private</u> investment is the prime driver of growth and jobs. To unblock private investment, we must complete the repair of the financial sector to restore the flow of credit to households and business. It is not about "bailing out bankers". It is about letting credit flow and create growth and jobs. Public and private investments are not contradictory, both are crucial to restore growth.

We must also look <u>beyond our borders</u> for growth, by embracing a forward-looking and proactive trade policy. In Europe, about 30 million jobs, or more than 10 % of the total workforce, depend on sales to the rest of the world. The decision last week by the US and the EU to initiate procedures to launch negotiations on a ground-breaking, comprehensive and deep free trade agreement – the Transatlantic Trade and Investment Partnership – is of enormous importance in this respect.

Successfully facing the sustainable growth challenge is critical if we are to raise living standards and service the debts that we hand down to future generations. With the future in mind, growth must indeed be sustainable, not only in economic terms but also in terms of its impact on the environment and climate. Green growth has great potential both in environmental and economic terms and needs to remain a top priority.

The **second challenge, fiscal sustainability,** requires staying the course of reform and consistent fiscal consolidation. Public debt in the EU has risen from around 60% of GDP before the crisis to around 90% of GDP now. On the basis of extensive economic research, we know that when public debt rises above 90% it tends to have a negative impact on economic dynamism, which translates into low growth for many years.

Nevertheless, public finances in the EU are gradually improving thanks to, on the one hand, enhanced EU governance tools, and on the other hand, determined effort by governments. This is mirrored by an increase in markets' confidence in the actions being taken by EU governments.

The situation does, however, vary substantially among Member States, which is why we apply a differentiated approach to consolidation, taking into account the specific challenges of each and every Member State when determining the structural fiscal adjustment effort needed. If growth deteriorates in an unexpected manner, a country may receive extra time to correct its excessive deficit, provided it has delivered the agreed structural fiscal effort and does the necessary structural reforms to underpin medium-term stability and growth.

Finally, our third challenge is rebuilding the Economic and Monetary Union. Last November the Commission put forward a Blueprint which presents the economic rationale to bring about the completion of EMU and outlines a roadmap with short-, medium- and long term actions to that end. It balances increased responsibility and increased solidarity. It also indicates the possible need for Treaty changes as far as deeper integration is concerned.

Throughout the measures proposed, ensuring democratic legitimacy is at centre stage. As representatives of national parliaments, you all know very well that parliaments are where legitimacy and accountability of policy decisions vis-à-vis the citizen are realised. It is to you that citizens turn for answers. This great responsibility requires finding the best way forward through an open debate and discussion.

The blueprint builds on the Community method. By allowing non euro area participation in the new arrangements whenever possible, ensures convergence between current and future euro area Member States.

For the short term (6 to 18 months), we envisage proposals within the current Treaties, starting with the banking union. The agreement on the Single Supervisory Mechanism reached in December was an important step. But we must also develop a European Resolution Mechanism. A resolution fund should build on contributions from the financial industry.

Also, we will come with proposals for increased prior coordination of major economic reforms. Due to our close economic integration,reforms in one country will often have spill-overs on other Member States.

We will also need to strengthen economic policy coordination and secure stronger ownership of reforms through contractual arrangements aiming to facilitate the implementation of structural reforms. They will define the more detailed measures to which the Member States commit themselves and which can be coupled with financial support.

In the medium-term (18 months to 5 years), we envisage further integration involving Treaty changes. Our **guiding principle** is that any steps towards increased solidarity and mutualisation of risk would have to be combined with increased responsibility; that is, with further sharing of budgetary sovereignty and deeper integration of decision-making.

Ladies and Gentlemen,

Let me conclude. The challenges ahead of us will not be resolved without hard work and serious efforts. There is no time for complacency. In the end, what we want to achieve with all of this is a competitive and inclusive economy that enables us to achieve sustainable growth and job creation, while maintaining our social model and ensuring a sustained rise in welfare. This requires an institutional set-up that supports these objectives. That's why rebuilding of the EMU is essential for our long-term welfare and for the sake of sustainable growth and job creation.

But we cannot get lost in institutional arm-wrenching, neither at national or European level. In looking to the future the over-arching objectives need to be at centre stage. Through hard work and team play I am confident that we can meet the challenges and achieve these objectives.