

European Policy Centre Annual Conference

'State of the Union'

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Intervention by Prof. Danuta Hübner

Your paper is rather gloomy. You point to the failures and fragility of European construction as well as to a general 'Europe fatigue'. You see as thinkable things which I see at the top of the never-to-do or never-to-allow-to-happen list. I share your concerns, but I cannot join you where you underestimate the political and institutional efforts over the last 2-3 years to bring the change that we need.

Living in interesting times is not just a pleasure. We know the Chinese dictum on the downside of it. But tough and interesting times are a fertile ground for the emergence of brave women and men who come with good and new ideas and solutions and who have the ability to convince others to risk a new course in history.

We did not envisage the crisis, we did not prevent it, but I believe we invested a lot in identifying its roots, and understanding why we have not been fast enough in getting us out of it. We discovered that the EU budgetary surveillance mechanism did not reflect the real situation, the enforcement of fiscal rules failed, non-fiscal risks were not monitored, we exited from the

crisis with a lack of clarity with regard to bail-out needs persisted, lack of fiscal coordination undermined market confidence. Member states did not take advantage of good times to generate sufficient fiscal space for the bad times. And the Stability and Growth Pact was toothless already at an early stage.

The SGP was originally to ensure that no single member state's fiscal policy would endanger the financial and economic stability of other member states. Due to an ineffective sanctioning mechanism and the presence of numerous escape clauses ("exceptional economic circumstances"), the pact was never, in fact, enforced. Despite cases of violations of the debt and deficit thresholds, no country was ever fined. This left the pact toothless already at an early stage.

Not only budgetary issues have been subject to too little or ineffective surveillance, but we have not been paying enough attention to those economies that lag behind in terms of structural characteristics, including the differences in the pension age, productivity, labour cost, asset prices, credit provision - all those as well as other key indicators differ widely across Europe. Such discrepancies in national economic fundamentals can lead to a dangerous extent of economic divergence between different countries, leading to some countries simply being unable to compete.

The crisis is a deep and existential experience for many people in the Union. It touches many in negative way. But overall I think we did not give up; we made efforts and we stepped up to the challenge. Fundamental reforms of the eurozone system have become urgent as it has become clear that the

problems go much deeper than sheer enforcement. But fundamental reforms are always difficult. And, as usual, when it comes to addressing fundamental questions, crisis has helped. It has forced us to rethink the economic governance of the Union and to put out a comprehensive package of reforms that would reduce the risk of future crises. The way we function is being changed to an unprecedented extent. Still all reforms do little to get us out of the debt crisis; they rather aim at prevention. But can a crisis be prevented at all? Most likely it is unlikely, so the change should be more about creating capacity to cope with crisis if, or even when, it happens. We have looked into every nook and cranny of the budgetary and fiscal processes, the mechanisms monitoring the risks and the systemic coordination of policies and enforcement of rules (or lack of thereof) and we are about to decide to overhaul the old procedures for the sake of something new. That the reform process was initiated with practically no resistance and that we got close to an agreement relatively fast, is in itself a proof of the fact that the Union is getting stronger. Last night we nearly concluded the trilogue on the sixpack economic governance legislation.

Of course we are in the middle of a crisis that has been born of fiscal irresponsibility of some Member States and a lack of European supervision. But is the solution to ask those Member States to simply comply with the austerity packages?

Many analysts today make lists of recent European challenges that go well beyond the factors behind debt and economic governance failures, like

growing xenophobic populism, restrictions to free movement of people, management of the debt crisis, foreign policy, etc. Many underline ineffectiveness in coping with migration, lack of progress in competitiveness of the European economy and exploitation of national interests and national perspectives to the solution.

But at the same time, paradoxically, new regulatory frameworks that emerge from this national interest focus bring more Europe. The financial sector is more integrated, economic governance - not only the sixpack reform, but also the European semester, national reform programmes, the euro-plus initiative - gradually give Europe a framework to better coordinate its policies, fundamental for its growth and stability. There is always the question - are we doing enough, shouldn't we move faster, deeper, more decisively towards system-wide solutions. The answer is yes, we should. Many of us have doubts about the insufficient level of ambition in this small-step policy of change.

We seem to be inward-looking, while the need to look outside, toward the global environment, is obvious for various reasons. Even when investing in domestic reforms, Europe must look outward toward global threats and opportunities.

Setting regulations in place is, of course, a challenge. But we are just at the beginning of a process which will require a lot of political will with regard to the enforcement of the new regulatory framework. Can we, through fines and

penalties prohibit individual Member States from pursuing policies that harm individual Member States and the Union as a whole? Sticks, fines and penalties are the instruments that didn't work in the past. And they are supposed to act now. Sanctions rarely generate ownership and responsibility. Can the coordination of 27 complex, complicated and diversified regimes and specificities be effective? A centralised fiscal regime will sooner or later be needed.

Despite the fact that the latest data are telling us that Europe is slowly emerging from the crisis, there are still many threats that we have to cope with today. The threat of a sovereign contagion is still looming around the corner, despite all the rescue packages that were adopted or might be adopted in the future.

There are underlying discrepancies in terms of economic situation in the euro area. There are economies which grow dynamically and these are rather rich economies and there are mostly poor economies that are confronted with austerity packages and unsustainable debts. This makes it rather likely that the crisis will draw a new map of European economy where the gap between the rich and the poor will be widened. The truth is that not only growth rates are less favourable in case of those more strongly affected by the crisis but that they also suffer from more severe adjustment difficulties. The challenge of a two speed Europe and a growing divergence is real.

It does not come as surprise that the crisis has pushed policymakers' attention to debts, fiscal austerity and governance reforms. But sustainability of reforms and debts depends on whether Europe will be capable of restoring growth. Europe is currently faced with an evident growth deficit. As it comes in the moment of austerity imperative, the question that we therefore have to address is how to finance the growth that Europe needs. It will not suffice to finance growth that will merely take Europe back to pre-crisis levels of GDP. Growth in Europe will have to be supply-driven, based on structural change and productivity gains and delivering a more competitive economy.

Poorer countries with adjustment problems and unsustainable debt are in particularly difficult situations with regard to the availability of resources needed to finance growth and restructuring. It will take time till private sustainable financing will be available. Therefore, the question whether and how the growing divergence will influence European politics is legitimate.

In general, all EU member states, not only euro zone will require huge volumes of financing in the years to come. Governments, regions, municipalities will have to borrow large sums both to pay debts and to grow. The task is to get the confidence of markets back, to convince those who make investment decisions that they should invest in Europe.

Over the last decade, since the euro has been put into motion, the world and the Union have changed dramatically. In particular the interdependence of financial markets has grown, as well as its direct consequence - the systemic

risk. For this the euro zone was not prepared. When problems emerged in 2010, granting financial assistance to a non-euro country was foreseen in the Treaty. But the EU did not have any legal instrument to provide assistance to the euro area member states. Temporary instruments of crisis resolution were established rather quickly, combining intergovernmental and communitarian approaches. Now the work on the permanent solution is well advanced. I hope that the new permanent stability mechanism will not remain permanently intergovernmental.

The European Semester of policy coordination is a crucial element in the new economic architecture of Europe. The crisis has left no doubts - linkages between national fiscal, budgetary, economic, social, growth and competitiveness related policies must be improved. In their respective National Reform Programmes, the member states will set out the action they will undertake in areas such as employment, research, innovation, energy or social inclusion; again adding to the coordination of economic policymaking in Europe. The European Semester, which the EP proposed to codify in the sixpack reform framework, is a six-month health check of national public finances, which allows for monitoring, surveillance and gradually a kind of supervision of persistent problems in the area of fiscal policies. Benefits of this novelty will emerge only over time, hopefully reducing the risk or even preventing a recurrence of a similar debt-rooted crisis. Nevertheless, the current debt problems must be overcome.

The intergovernmental approach to the increased cooperation on economic and fiscal issues should be seen as the second best solution. It has been considered by member states as the only possible way to move forward. It must, however, as soon as possible be replaced by more effective approach based on the mechanism of the community method.

A legitimate question today is about the political space in the reformed EU for those member states that are outside the eurozone. All the proposed regulations are intended to safeguard the stability of the euro and it remains unclear what claims non-eurozone countries will have to the rescue mechanism and what their role will be under the SGP and the new macro imbalances procedure. In the European Parliament, we have negotiated the possibility of opt-ins for all procedures in the economic governance package, but until now nobody seems to know what the legal implications of such an opt-in would be and to what extent these countries would be able to participate in the package on an equal footing with the eurozone member states.

To conclude, we have managed to implement structures that several years ago were unthinkable. Ironically, we have to thank the economic crisis for this; a crisis that might have been prevented if such a system would have been put in place years ago.

There is no better economic choice than euro and no better political choice. We are all increasingly interconnected and interdependent. European unity is

the only path to follow in the context of globalization. We also depend strongly on how major challenges - climate change, resource efficiency, energy security, demography, FTT - are handled globally. We are too small not to be united and our common interest is to be involved in global solutions and to lead them. On this we can be efficient only if we act together.

Why have we embarked on those fundamental reforms only now? For many reasons. Certainly, one can say that when final decisions on the eurozone architecture were made, there was no political will to go further in terms of political integration. It seemed justified to assume in the then market situation that monetary integration would lead gradually to stronger political integration while the Stability and Growth Pact would play its fiscal disciplining role. However, growing interdependence of financial markets and explosion of new financial instruments led to growing volatility and contagion potential.

Of course, what can be done today on the reform path reflects a balance between what is required and what is seen as feasible. Nevertheless, what has been already done is the strengthening of Maastricht mechanism. There is a certain new dose of fiscal risk sharing. Debate on even more fundamental reforms has been opened for which political appetite is not yet with us.