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In Search of Smart, Sustained and Inclusive Growth

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Thank you, Professor Dahlsten,

Professor Cable,

Ladies and gentlemen,

It is a pleasure to be here today and to have the opportunity to discuss Europe's growth perspectives with you.

There is an apparent Catch-22 in Europe's search for growth: when times are good, the case for reform is too weak to convince some, and when times are hard, the context for reform is supposedly too difficult.

Over the last few years, Europe's quest for growth has tried to find a way out of this paradox: first, by addressing the mistakes of the past, in terms of debt, imbalances and the main structural weaknesses in the set-up of the Economic and Monetary Union. Second, by keeping up the pressure for the policy and institutional reforms we need for sustainable growth in the future, and, third, by giving the impulses the economy needs to improve the reform environment right now.

All aspects are equally necessary, so we always knew this would be a huge undertaking.

The main challenge now is to stay on course.

So, how are we doing at the moment?

First the good news. Since 2014, growth has gradually picked up, and the EU's economy is recovering. Our economic fundamentals have been strengthened by often difficult but necessary reforms, a return to financial stability and initiatives to revive investment. A number of EU actions – including the establishment of firewalls and the banking union – have helped to stabilise our economies and lift confidence.

The results are starting to show: unemployment in the EU fell below 10% in 2015 for the first time since the crisis and is set to decrease further. Lending to the real economy has picked up in the euro area and real wages have started to increase.

As for the strengthened credibility of the monetary union, it's important to note that market reactions to the last Greek crisis were notably subdued. This was seen as a Greek problem, serious enough in itself, but there were very limited spillover effects to other euro area countries.

It underlines the fact that the reforms of the euro area governance structure - stricter macro-economic and fiscal surveillance, the banking union and the European Stability Mechanism – have really paid off.

There are, however, considerable risks ahead. The recovery remains slow and fragile. More than before, growth will also need to come from within Europe: over the last months, the external environment has become more challenging due to economic slowdown in China and other emerging economies and nervousness on international financial markets and the global growth outlook for 2016 is being revised downwards.

So is the political context: security concerns and geopolitical tensions weigh heavy on everyone's mind. The refugee crisis is a serious challenge for Europe's decision makers. Populism is a constant threat. But we cannot allow the focus on economic reform to slip.

So far, the EU economy has managed to weather the storm. But domestic weaknesses persist in several Member States. 12 EU countries are still experiencing macroeconomic imbalances - such as high public and private debt or weak competitiveness - 5 are experiencing excessive economic imbalances. Even if this is an improvement on last year, these imbalances remain a source of vulnerability.

Given these challenges, it is crucial to nurture the economic recovery and accelerate the drivers of growth. Further reforms are needed to strengthen competitiveness, while maintaining fiscal responsibility.

There is often a discussion about the reasons why we have left the worst of the crisis behind us: structural reform or monetary impulses?

But that is not the right question: while overall very helpful in the current circumstances, monetary policy alone cannot fix structural challenges of an economy, nor is it without risks. The support and time provided by the European Central Bank must be used to drive forward sometimes long-overdue reforms.

We also need to be aware that quantitative easing will come to an end at some point. Then fiscal policies must be able to step in and play a greater role. This implies the need to return to sound fiscal positions to be able to let automatic stabilisers operate fully.

Economic and social convergence within and among Member States, which was one of the main goals of European integration and indeed: one of its main success stories before the crisis – needs to be put back on track.

The annual economic policy coordination cycle we call the European Semester plays a central role in achieving this. It is guided by the Commission's Annual Growth Survey, which sets out three economic priorities for this year, namely:

- re-launching investment;
- structural reforms to modernise our economies;
- and responsible fiscal policies.

Investment

Despite its recent recovery, the EU economy is still suffering from low levels of investment since the beginning of the global economic and financial crisis. Current investment levels in the EU are well below what is considered an unsustainable trend level of 20-21% of GDP.

There is plenty of liquidity available in Europe, and yet investment does not take off as it should.

Why is that so?

Uncertainty plays a major role - lack of risk financing and lack of certainty regarding the projects - and regulatory barriers and fragmentation continue to hamper investment. We have a strong risk averseness of both lenders and borrowers.

Therefore, the Commission's Investment Plan has three mutually reinforcing pillars:

- The first, the European Fund for Strategic Investments, aims to mobilise, in cooperation with the European Investment Bank, at least €315 billion in new public and private investments in areas of strategic importance to the EU economy over the next three years. This was the first major policy initiative of this new European Commission.

Since its entry into force in July 2015, the European Fund for Strategic Investments has been helping to mobilise private capital for infrastructure and innovation projects in key sectors like energy, resource efficiency, transport, broadband, research, health, SMEs and Mid-Caps.

After only nine months, we have agreed projects in 22 Member States for more than €76 billion of investments. This is 24% of the €315 billion target.

- The Investment Plan's second pillar rests on tools to help projects become investable: The European Investment Advisory Hub is Europe's gateway to investment support and expertise. And the European Investment Project Portal is a transparent, web-based pipeline of investable projects in the EU.

- Finally, we need to remove barriers to investment both nationally and at EU level. This third pillar of the Investment Plan is focused on removing bottlenecks to investment, providing greater regulatory predictability, and reinforcing the Single Market.

The Commission's analysis of investment challenges in each country – as part of the European Semester - shows a lot of diversity in investment patterns and barriers to investment. So there is no one-size-fits-all solution, but with a targeted approach we can do a great deal.

For the EU as a whole, the Commission has started to address a number of barriers to investment notably through developing a Capital Markets Union, deepening the Single Market for goods and services, creating a Digital Single Market, and improving the Single Market in transport and energy. In parallel, the Commission's Better Regulation agenda seeks to simplify the legal framework and to reduce regulatory burden across the single market.

Structural reforms

The issue of investment bottlenecks naturally brings me to structural reforms.

Structural reforms are crucial for all EU countries, to make them more competitive and productive. In the euro area, these reforms are even more important as, in the absence of national monetary policies, product and labour markets need to be flexible enough to adjust to shocks.

Estimates by Commission staff confirm how powerful structural reforms can be. In the short-to-medium run, labour market, tax and product market reforms have the largest effects. In other domains, like education and R&D, benefits are clear in the longer run.

Simulations show that if Member States carried out reforms that close half the gap with the best performers, EU GDP could increase by 3% in five years, almost 6% in ten years and 10% in twenty years.

The record of structural reforms in recent years is rather encouraging when compared with the lack of progress registered in pre-crisis years. The worst-hit countries are often making most progress – though there is room for improvement.

On some of the reform directions, of course, structural reforms are country-specific and there are different issues being addressed in different Member States, but some of the recurring issues include:

- Labour market reforms to find the right balance between flexibility and security and to reduce segmentation of labour markets;
- Long-term sustainability of social and pension systems, given the ageing population;
- Shifting the tax burden away from labour, especially low-paid labour, to other tax bases less detrimental to growth, such as consumption, property, capital environmental taxation;
- opening up closed professions; and so on and so forth.

Reforms in Member States need to be reinforced by efforts at EU level. To improve the Economic and Monetary Union and the Single Market, we have identified the following priorities:

- First, the Capital Markets Union aims to increase the funding sources for Europe's businesses. This will provide firms with alternative sources of finance, complementary to bank financing, that are more widely used in other parts of the world, notably in the USA.
- Productivity also grows when resources are reallocated to the most productive companies: the Single Market Strategy and the Digital Single Market are instrumental for removing bottlenecks to this, such as consolidating Europe's intellectual property framework and granting better access for consumers and businesses to digital goods and services.
- The Energy Union makes the best use of opening up the energy markets to Member States and to ensure the necessary interconnections.

So structural reforms in Europe have progressed significantly over recent years. But there is still some way to go, and we need to stay on course.

Structural reforms take time to implement and take effect. Do we have that time today? Or should we focus on short-term measures to counter rising global uncertainties and a moderate short-term growth outlook?

I think that would be a grave mistake. As global economic uncertainties are on the rise, we need to strengthen business and investor confidence in Europe's growth outlook. The best way to do so is to tackle structural weaknesses head-on. I am therefore convinced that Europe must accelerate implementation of reform agendas, to consolidate confidence, and to allow reform effects to feed into economic growth as early as possible, and to real benefits in people's pockets.

Fiscal policy

Growth-friendly and responsible fiscal policy is another key element to support sustained and inclusive growth. Sustainable public finances are the cornerstone of our economy, and a fiscal policy that smoothes economic cycles is one of the vital elements to hold it together.

As a rule, the aim is to reduce public deficits and debt when economic times are good, so that we can use budgets to counter downturns when necessary.

As we know, this has not always been the case in the past. Some EU Member States did not take advantage of the good times after the introduction of the euro and entered the crisis with already high debt levels. To manage their fiscal positions, some Member States then had to go through very sharp adjustment.

Here, I would also outline some of the experiences and examples from the country I know best, Latvia, and also some comparisons.

Back in 2008-2009, Latvia was the EU Member State most affected by the crisis, facing the deepest recession. The question was what needed to be done to return to economic growth as quickly as possible. To do so, in the case of Latvia, it did so-called front-loaded fiscal adjustment. We did the bulk of the adjustment early on, during the crisis, especially in 2009. As a result, we were able to return to financial stability quickly and, already in the second half of 2010, to return to economic growth. The important lesson is that financial stability is a precondition to economic growth.

To compare this with the situation in Greece, which used the argument of delaying the adjustment because fiscal adjustment is bad for the economy, and so let's keep the economy stabilised and deal with our debt and deficit later on. Unfortunately, by delaying the adjustment, Greece has also delayed financial stability and, without financial stability, it was not able to return to economic growth. As a result, Greece entered a much longer and deeper recession and, eventually, made the adjustment need bigger not smaller.

Another example is Ireland, which also chose a similar strategy to Latvia, did front-loaded fiscal adjustment and is now the EU's fastest-growing economy.

If you look at the overall picture, EU Member States' public finances have substantially improved in recent years. Both deficits and average public debt are on a downward trajectory. The average deficit in the EU is expected to decrease from 2.5% of GDP last year to 2.2% of GDP this year and public debt in the EU had peaked in 2014 at 88.6% of GDP and is now on the a downward trajectory.

But many countries are still faced with risks.

Some of them have public debt stagnating at, close to, or above, 100% of GDP. A lack of prudent fiscal policy in good times has thus limited the current room for manoeuvre. Other countries, with less sustainability concerns, have room to increase investment to boost potential growth, for instance in infrastructure, education and research.

The overall picture is uneven. There are some Member States with fiscal space, there others which still have excessive deficits and need to continue their adjustment effort.

Geopolitical challenges

Ladies and gentlemen,

Our economic agenda runs the risk of being overshadowed by political and geopolitical challenges.

Understandably, Europe's political focus is mainly on the refugee crisis and terrorist threats, on the security impact of conflicts to the east and south of Europe - and indeed: on this country's willingness to stay a part of the European Union.

However, it would be wrong to ignore our economic revival and renewal even at such a time. I would even say: we need them especially at such a time. Our place in the world – our soft as well as hard power – will always depend on our ability to safeguard our economic fundamentals and on the success of our social-economic model.

The refugee crisis, for instance, demands more effective and unified border management. It demands funds to support migration partnerships with countries like Turkey and across Northern Africa. And as it evolves into an integration challenge, it also requires economic opportunities for people, well-performing labour markets and sustainable public finances. We won't be able to meet this challenge unless we have strong and stable economic foundations.

Another example is Ukraine, where providing access to the European market and concrete macro-financial assistance are the best tools we have to support the economic recovery in Ukraine. Of course, this goes hand-in-hand with political and economic pressure on Russia to play a constructive role in the stabilisation on the situation in Eastern Ukraine.

Within the Commission, we are thinking about how to strengthen our Macro-Financial Assistance Facility, which we use in Ukraine, to allow us to contribute more – and more effectively – to financial stability in regions of strategic importance for the EU. This is important, but it demands a flourishing economy, which can only be based on the reforms outlined earlier.

And more broadly, the legitimacy of the European project depends on its clear and concrete contribution to citizens' welfare. We absolutely have to make our economy work.

Thank you.

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