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Structural economic policy priorities for Europe

*Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort*

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Ladies and Gentlemen,

It is my great pleasure to join you here in Paris this evening and I would like to thank the OECD and the IMF for inviting me to speak tonight. I will take this opportunity to talk about the key priorities for structural reform in Europe - our agenda for the next three years, as well as the importance of complementing this strategy with sound macroeconomic policies and the benefits that can arise from coordinating European reform efforts.

I do not need to stress how vital structural reforms are for the economies of the EU— we know that they are essential if we want to guarantee Europe's place in the 21st century economy and sustain prosperity for generations to come.

Therefore, making sure that adequate reforms are launched and implemented, and that the momentum for change does not slacken, is a critical concern.

At last week's Spring European Council held in Brussels, the 27 heads of State and Government took a significant step forward with Europe's reform agenda by reaffirming their commitment to the Lisbon Strategy and endorsing the new three year cycle of the Strategy for growth and jobs, covering the period 2008 to 2010.

The launch of the new cycle is accompanied by the knowledge that sound macro-economic policy instruments alone are not sufficient to boost productivity and increase potential growth.

Moreover, the new cycle begins just as we enter more difficult economic times, when structural reforms become even more important to improve the resilience of our economy to shocks.

What then are the challenges that the EU faces in the years ahead?

Europe now finds itself at a crucial crossroads, confronting both internal and external pressures:

We face an urgent need to prepare our societies and economies:

- for an economy based on knowledge rather than manufacturing;
- for an ageing and declining population;
- and for an intensely integrated and competitive global arena in which natural resources are declining.

Indeed, the substantial changes in relative prices, caused by climate change and tension on natural resource markets, are likely to present a stiff challenge for most EU countries.

We may be coming to the end of the period of 'great moderation' which has assured us growth and stability for over 20 years. If so, this would make supporting economic growth while maintaining price stability a much more demanding task in the years to come.

These trends will become more and more relevant in the future and we will need to be well prepared to deal with the economic challenges they bring.

But there is an additional and more immediate reason to put implementation of reforms at the top of the agenda this year.

We are no longer enjoying the buoyant economic climate of the last two years. We are no more in economic "good times".

Uncertainty is high as the turmoil in global financial markets continues to work its way through the system. The US economy is clearly slowing, perhaps even entering a recession. Meanwhile oil prices are reaching record highs, accompanied by increases in other commodity prices.

But even if some EU member states are facing macroeconomic imbalances, it's fair to say that so far the European economy has responded rather well to these volatile conditions.

Last month we have had to revise our growth forecasts down slightly; and the EU is now predicted to grow below potential this year.

But 2% is clearly far from the risk of recession.

Nevertheless, in a deteriorating economic climate, we urgently need to increase the reform momentum to limit the effects of a temporary slow down.

Structural reforms make our economies more flexible and resilient by increasing potential growth and improving our capacity to adjust to changing economic conditions.

They are among the best tools we have to weather the current storm.

In view of this, let me look at the progress we have made with structural reform in Europe so far and the priorities for the new Lisbon cycle.

A good number of structural measures carried out by EU Member States over the last years are now beginning to yield tangible results, even though these have occasionally been slow to materialise.

The most dramatic improvements are evident in labour markets where unemployment in the EU is now at its lowest in 25 years. 17.5 million new jobs have been created since the beginning of this decade – of which 6.5 million were created in the last two years alone.

But it is also true that the largest part of the productivity rebound during the last years has been due to cyclical factors and US productivity growth has outpaced the EU during the 1995 to 2005 period.

I know that, in some sectors, such as telecoms, permanent efficiency gains do seem to have been achieved in Europe, which may reflect important efforts to liberalise the market.

Nevertheless, our record in product market reforms remains mixed. Most notably in services, where a serious lack of competition is holding back productivity growth.

These challenges are also identified by the OECD in the 'Going for Growth' report, with which we have a convergence of views in this respect.

The conclusion is obvious. We must accelerate reform efforts and seek structural improvements in all areas where a lack of efficiency has been identified. And we need to do it now, when the EU's resilience to economic shocks is increasingly being tested.

That was the Commission's core message for EU leaders last week and I am glad they have agreed that this is the best way to address the challenges posed by globalisation, climate change and an ageing population.

The European Council concurred with our opinion that the main instrument in the Lisbon process – the Integrated Guidelines for Growth and Jobs - and the specific policy recommendations addressed to each of the 27 Member States will remain broadly stable for the 2008-10 period.

There is no need for a radical overhaul of the guidelines. We have identified the right policy responses – our task now is to turn reform commitments into concrete action. The key word is delivery. The key task is implementation.

However, this does not mean that the Lisbon Strategy is static. On the contrary, we will launch a series of new initiatives that were approved last week by EU leaders.

For example, we agree with the OECD report that education is a major concern for EU Member States. It is vital that every European is given the opportunity to flourish in the world of work. This is why we are calling on Member States to draw up action plans and set targets to substantially reduce early school leaving.

We also share the OECD's view on the need to improve labour utilisation. Therefore we recommend the development of lifelong learning strategies as well as active labour market policies that will increase the flexibility and security of our labour markets.

In addition, we place a great deal of emphasis on R&D and innovation for the next three year cycle. Which is why we will be taking further steps towards the 'fifth freedom' – the free movement of knowledge - by setting up a genuine European Research Area and creating a European patent to protect innovation and knowledge.

SMEs create 90% of new jobs in Europe and we recognise the crucial role they play for our economy. So a major priority is to improve business conditions for European companies through better regulation. In particular, the Small Business Act that we are launching this year aims to remove legal and administrative obstacles for EU companies and foster the growth of millions more SMEs in Europe.

On top of these reforms, we will also pay a great deal of attention to addressing the impact of ageing and tackling the challenges associated with energy supply and climate change.

But as we begin this new cycle of the Lisbon Strategy, we are fully aware that to raise potential growth on a sustainable basis requires both sound macro-economic policies and comprehensive structural reforms.

With this in mind, I would like to focus for a moment on the interaction between these policies.

Sound macroeconomic policies, notably fiscal policy, are a key pillar of the Lisbon Strategy. Debt reduction and healthy public finances will be essential to cope with the impact of an ageing population.

But sound macroeconomic policies will also provide the best framework to reap the full benefits of structural reforms. Fiscal and monetary policies that anchor stability have a direct bearing on lowering unemployment, mainly by reducing risk premiums on interest rates and the servicing of debt, thereby improving the conditions for investment and growth.

However, macroeconomic stability alone does not equal higher growth. For that we need microeconomic reforms that improve conditions for higher labour utilisation, investment and innovation.

My principal argument here is that structural reforms and sound macroeconomic policies are mutually reinforcing. There can be no trade off between the two. Sound macro-economic policies are a pre-requisite for any reform strategy to succeed.

But while it is probably easier to carry out reforms when fiscal positions are sound, I do not see any contradiction between adhering to the Stability and Growth Pact and conducting structural reforms.

Let me stress that most reforms do not necessarily entail budgetary costs. Product market reforms, in particular, are rarely accompanied by a deterioration of public budgets. Reforms to improve the quality of public finances may even, via their growth-stimulating impact, improve the budgetary position.

In any case, the improved budgets that most EU Member States currently enjoy, the best in many years thanks to significant consolidation efforts, provide them with more leeway to press ahead with reform.

Moreover, the nexus between structural reform and public finances is explicitly addressed by the Stability and Growth Pact. Since the revision of the Pact in 2005, there are now specific provisions that allow for the possibility to consider structural reforms when assessing a budgetary deficit, if they clearly lead to benefits over the medium term.

The question nevertheless remains of how to create further incentives for Member States to engage in a serious strategy of reform. This is an important issue and one that will be looked at carefully in the context of our upcoming communication on EMU@10 – our analysis of the first 10 years of the Economic and Monetary Union in which we reflect on the policy agenda for the euro area over the next decade.

Let me now turn to the final part of my presentation. So far I have spoken about our reform priorities for the current cycle, and about the need to combine this agenda with sound macroeconomic policies.

But there are also important benefits to coordinating European reform efforts.

Euro area economies are in particular need of improving microeconomic conditions. Membership of EMU has not been accompanied, in general, by an acceleration in structural reforms. This despite the fact that, in the absence of monetary policy and exchange rate tools, euro area members depend more than other countries on flexible markets to adjust to changes in competitiveness.

It is therefore imperative that euro area members press ahead with structural reforms. Enhancing competition in service markets, integrating financial markets, ensuring adequate wage developments and establishing a better combination of flexibility and security on labour markets have all been singled out as especially important for the good functioning of EMU.

And structural reforms can also have a more powerful impact and deliver benefits faster in a monetary union if implemented in a coordinated way rather than on an individual basis.

As part of a concerted action, national reforms would be more credible, and hence could more rapidly bring about a positive change in the behaviour of citizens. This is essential for the good outcome of reforms and may be more easily perceived as a change which can improve the functioning of the economy, and in turn lead to more favourable price developments.

In a more general sense, reforms may yield higher benefits when they are pursued in a comprehensive manner rather than individually, as this can generate important synergies. For example, product market reforms are more powerful in flexible labour markets because workers can then move more easily from shrinking to growing sectors.

Another reason for coordination is that reforms in one area can have important knock-on effects by highlighting the need for reform in other areas and stimulating further action.

Domestic resistance is often an important obstacle to change in Member states. Particularly when the effects of reforms or the costs of non-reform are hard to grasp for the public. So learning from the experiences of other countries, promoting best practice and establishing peer pressure can all be useful tools in the coordination of structural reforms.

Rapid and joint implementation of reforms envisaged in the Lisbon strategy can be a clear example of effective coordination of economic policies.

Conclusion

Ladies and gentlemen,

Let me conclude by stressing once again that reforms work. They have helped support the economic recovery of the last two years and they are now helping us weather more turbulent times. So stepping up reforms just as they are beginning to deliver results would be the best possible response to the storm clouds gathered over the global economy and to the challenges that we will face in the coming years.

Lisbon is working but we know that the strategy can deliver much more in the 2008-2010 cycle. Pressure on the concrete delivery of reform commitments especially in a new, more uncertain economic climate, must continue.

If we hope to move Europe forward, to excel in the networked and knowledge based economy of the 21st century, to sustain our values and prosperity for generations to come, we must urgently and collaboratively drive forward change.

Once again, I extend my thanks to the OECD and the IMF for inviting me here this evening. It is our shared objective to establish a dynamic global economy and I value the contribution our organisations can make to realise this goal.

Thank you for your attention.