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Closing address

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Ladies and gentlemen,

Introduction

Five years ago, we embarked on one of Europe's most ambitious journeys along the road to integration so far.

Building on the work of our predecessors, this Commission has overseen the physical introduction of the euro. This Commission has also played a full part in economic governance of the euro area.

Five years down the road, we can see significant achievements. But we must also acknowledge some difficulties.

The proper functioning of the euro area requires close cooperation between participating Member States. They need to acknowledge that a common currency means their economic fortunes are closely interwoven.

That was why rules were put in place at the outset to ensure coordination and fiscal discipline.

But since 2001, an economic slowdown occurred before all Member States had completed the consolidation of their budgets. And this has put considerable strain on economic governance in the euro area.

As events have unfolded over the last two years, the framework governing economic coordination -- and in particular the Stability and Growth Pact -- was adequate for the first stage. But it has become clear that it now needs improving.

This is why this Commission presented broad proposals earlier this month to adjust our economic governance system.

It is my firm belief that these proposals -- which Commissioner Almunia has already outlined here this afternoon -- will bring a stronger and more credible Pact.

I am very pleased this Commission has been able to do this before the end of its term. It brings to completion a long and arduous journey which we started more than two years ago.

Need for coordination and strong fiscal rules

Let me elaborate.

Economic and Monetary Union needs rules that are clear and effective to ensure stability and growth. The Stability and Growth Pact lays down these rules and is therefore essential for the stability of the euro and the health of the European economy.

The Pact has been effective. In stark contrast with the fiscal profligacy and high interest rates of past decades, the Pact has brought stability and historically low interest rates. And this has given the euro area a better foundation for growth.

Limits of current governance and coordination framework (SGP)

But two years ago, in the midst of the economic downturn, it was already clear to many of us that our governance system needed to be refined. Since then, the limitations of the current rules have become clear to everyone.

First, while rules should be as clear and as simple as possible, economies are complex. So implementation must take this complexity into account when the rules are applied across countries and across the business cycle.

But the current rules hardly permit the system to make such judgemental evaluations.

Second, the coordination framework in which the Pact is applied has limitations, as the events of November last year amply illustrated.

There are a multitude of coordination processes -- the stability and convergence reports, plus the country contributions to the broad economic guidelines, to name just two.

In spite of this, there is far too little shared thinking on the strategic direction of individual economies -- let alone on the aggregate policy stance or the policy mix.

Third, the rules of the Pact do not sufficiently provide the scope of economic policy coordination necessary to promote growth in Europe.

Coordination has brought stability, but has not yet helped to bring about the structural reforms that are necessary to step up growth.

It is with these limitations in mind that almost exactly two years ago, I called for more intelligence to be introduced into the Pact.

It caused an uproar, but sometimes one must speak out if one wants to move forward.

I believe that time has proved that the concerns I voiced then were real, and that the Pact does need refining.

Providing the foundation for better governance

Since my declaration in 2002, the Commission has done a lot. As early as November 2002, Pedro Solbes and I put forward a number of ideas to improve the way the Stability and Growth Pact was implemented.

But the time was not yet ripe. It took more economic challenges and more work by the Commission finally to come up with the proposals presented by Commissioner Almunia.

I believe that our proposals address the shortcomings in the current fiscal rules. They provide a better balance between growth and stability. Overall, they make the rules economically sounder and acknowledge the findings of the Court of Justice -- namely that the Council and the Commission share responsibility for upholding the Pact.

Let me elaborate briefly.

First, while rules are an essential part of any framework to ensure fiscal discipline, they need to be applied in an intelligent manner. We must take greater account of the **complexity of our economy and the diversity** of our component national economies that make up the European economy, especially after enlargement.

Our proposals seek to achieve that. If they are adopted, the <u>preventive</u> elements of the Pact will be strengthened. Fiscal rules will be more closely adapted to the complexity of the European economic landscape.

In particular they will lay more focus on other key economic variables. Accordingly, the Pact will focus less on short-term limits and take more account of long-term growth and sustainability requirements.

Moreover, if our proposals are adopted, crisis management will be strengthened as the Excessive Deficit Procedure will also provide more scope for richer, sounder, economic reasoning.

Our proposals seek to reconcile equal treatment with due account for the complexity of our economies. They seek to reconcile clarity and simplicity with the need for sound economic decision-making.

I firmly believe that all euro-area members -- large and small -- should abide by the same, economically sound rules.

Secondly, **coordination** of economic policies needs to go beyond the purely disciplinary aspect. We should remember that sustainable public finances are a means to an end -- that is, they should seek to enhance our growth potential.

To improve growth in our economies, we need to create an environment where fiscal strategy, structural reform and growth are better coordinated. Our proposals contribute to that need.

But -- and this is the third point I want to make -- rules and coordination are not enough. Given the complexity of our economies, and thus, the need for guidance that is both rigorous and intelligent, our system of governance cannot work as an automatic pilot that applies the rules mechanically. It needs **authority** as well.

Only a system that has credible authority can apply the rules firmly and at the same time use them to take the right decisions in changing circumstances. And we need authority in order to intervene in defence of the common good.

Responsibility -- and hence authority -- for the final decisions on *enforcing* the Pact essentially lie with the Council.

A President of the Euro Group has recently been appointed for two years. This is just one step, but it is a welcome development.

A President appointed for such a longer term will provide more consistent guidance to Member States. And he or she will give the euro area a much-needed political voice.

While it is clear the European Central Bank is responsible for monetary policy, it has not yet become apparent who is responsible for explaining, say, the coordination of fiscal policy to the public.

But authority cannot be confined to enforcement only. In fact, enforcement is only the last stage in a long process.

An effective system needs authority to steer it, so the common interest is safeguarded and promoted. And the Commission is well suited to such a steering role.

Its authority derives from two sources:

- It rests partly on formal powers. In this respect, I have long argued that the Commission needs the power to issue early warnings if it is to be fully capable of acting in the common European interest. Our proposals are in line with this.
- But the Commission also derives authority in a less formal, though no less substantial, way -- by arguing the common interest and underpinning it by solid economic analysis.

In short, if they are adopted, our proposals would change the way we apply the Pact. I am aware that some would like to retain the current rules, which have many advantages at first sight:

- They are fairly straightforward and therefore create a sense of legal certainty.
- They also create an impression of equal treatment,
- And they offer clear incentives: limit the deficit or face sanctions.

But as economic history has illustrated time and again, rules based on automatic responses -- no matter the situation -- are <u>not only</u> a political illusion <u>but also</u> ultimately tend to be unwise. And they may be circumvented.

The reality is complex. This is why, when applying the Pact, one cannot avoid making a judgment based on other economic variables that affect the situation. For instance:

- Is a budget deficit not more serious in a country with high debt levels than in a country with low debt?
- Is correcting a deficit not more difficult in protracted periods of low economic growth than in good times?

By providing scope for a richer, sounder analysis, I believe our proposals will make the Pact economically sounder.

The proposals will enable the Council and the Commission to assess deficits against a broader economic background.

They will accordingly focus our attention on the core objectives of our common rules: fiscal discipline as a *means* -- not an end in itself -- to ensuring sustainable public finances. Just as sustainable public finances are a *means* to achieving higher, sustained growth and prosperity.

Lastly, let me say a word about fiscal **statistics**. Like a sound currency, good statistics are a common good for the euro area.

Our Communication proposes measures to enhance the quality, timeliness and reliability of fiscal data.

As recent events have proved once again, such measures are absolutely essential.

We want surveillance and coordination of economic policies to continue to mean just that. We want to avoid putting our common currency at risk. And that means making sure fiscal statistics are credible.

Concluding remarks

The rules for ensuring fiscal discipline have been hotly debated over the last few years.

Our proposals bring to fruition a process spanning more than two years -- two years spent looking at how best to improve the current framework.

I want to take this opportunity to express my gratitude to Pedro Solbes. As Commissioner for economic and monetary affairs, not only has he applied the current rules dedicatedly, but he has also been instrumental in initiating thinking on improving them.

I also want to thank Commissioner Almunia for his excellent work on these proposals since he joined the Commission.

It is my firm belief that our proposals will provide for a stronger and more credible Pact.

I believe we must put in place a framework that is more intelligent and economically sounder than previously.

I believe these proposals will enhance the Pact's contribution to the wider economic challenge facing Europe today -- enhancing our growth potential.

As I have always said, strong, credible rules are essential for Economic and Monetary Union to function properly. I am glad this Commission has put forward proposals that will contribute to that aim.

Thank you.