
Speech at the Peterson Institute for International Economics

« Europe's pivotal year »

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Ladies and gentlemen,

I am very pleased to join you today; thank you for inviting me again. A year has passed since I last stood in this room and there have been one or two notable changes in the world since then, as we all know, and not least here in Washington.

The challenges that lie ahead for Europe now are mostly of a political nature. This will be a pivotal year for us. On March 29, Theresa May triggered the so-called “Article 50” to begin Britain’s exit from the EU. Elections in large Member States – first France, now the UK in June, then Germany, and finally Italy most likely early next year – will shape the political landscape in Europe for half a decade. And some of the decisions made here in Washington will also drive Europe’s policy response in a number of areas – including defense, trade, or the fight against climate change. Finally, there is the fact that Russia has decided to move once again into a directly or indirectly aggressive stance on the foreign stage.

I am confident that Europe can emerge stronger from the current and upcoming challenges – as long as we know where we are headed.

My message to you a year ago was simple: the European economy was continuing to recover, but at a pace that none of us could be satisfied with. The good news is that the recovery has been firming and broadening across sectors for the past year. The EU economy is in its fifth year of recovery. EU GDP is expected to continue expanding at about 1.8% this year and next. For the first time since the crisis, we forecast growth in all EU Member States across our three-year forecast horizon. Unemployment has fallen to an eight-year low. In the eurozone, the aggregate public deficit and the government debt-to-GDP ratios are expected to fall further in 2017 and 2018. In short, we are making progress.

But let's be clear: while our economy is strengthening overall, the picture remains highly diverse from country to country, particularly within the eurozone. Several banks are still experiencing high levels of non-performing loans, which ultimately have a negative impact on bank lending to the economy. Investment is improving, also thanks to the Juncker Plan, but is still too low. Public debt levels remain very high in some countries, and with unemployment still at 9.5% in the eurozone there is really no room for complacency. These are issues that must be taken seriously.

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I am convinced that reversing socio-economic divergence in the eurozone is the prerequisite to ensuring the sustainability of our single currency – and to containing rising populism. I would further argue – and this is perhaps a provocative statement – that the incomplete governance of the eurozone has produced economic divergence rather than convergence between and within its members. And this divergence has in turn fuelled populism, which has its roots in economic discontent.

France will go to the polls on Sunday in an election that has people biting their nails well beyond my country's borders. And it is a paradox that while the vast majority of French citizens feel strong attachment to the single currency, polls indicate that candidates who think France should leave the euro – Marine Le Pen on the far right and Jean-Luc Mélenchon on the far left – are supported by approximately 45% of people answering these polls. This is indicative of the ambivalence felt by citizens about the single currency, which is of course not confined to France.

Let me be clear. European citizens and companies give credit to the single currency for simplifying their travels and cross-

border business, and for stabilizing European economies during the crisis and fostering cross-border trade.

But citizens are also disappointed that it has not given more of a boost to their wellbeing. Because the euro is not only a monetary project – it is also a political promise of prosperity. And they are right, as evidenced by the fact that growth and employment have returned to their pre-crisis levels in the United States, while the eurozone is still struggling to regain its footing. In the words of former Commission President Jacques Delors, “*the euro protects but it does not stimulate.*”

A two-speed eurozone has emerged, with regional clusters of excellence (for example in southern Germany, Austria, Luxembourg, parts of the Netherlands, Flanders in Belgium, or northern Italy) and areas that are now clearly lagging behind. The legacy of the economic crisis – i.e. ballooning public debts, aging infrastructures, the erosion of public services, the degradation of human capital – is both pro-cyclical and unevenly distributed in the eurozone. If this situation persists, it is hard to be optimistic about the prospects for the euro over the next five-to-ten years. So we need to address it, quickly and decisively.

There are telltale signs that the overall dynamic in the eurozone is not sound. Italy's public debt is twice that of Germany. Germany's

current account surplus is twice the eurozone average. German unemployment is half the eurozone average. And with this economic divergence, policy preferences are also becoming more and more polarized, both within and between Member States.

This seems to indicate that our economic governance is not producing the right policy mix – partly because we do not have the right policy *tools*.

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During the crisis, eurozone governance was strengthened significantly. We established the European Stability Mechanism; we began to build the Banking Union, with a single supervisor, a new framework for bank resolutions, and strengthened prudential regulations. And we significantly strengthened the coordination of economic and budgetary policy.

These were important innovations, and the eurozone is stronger as a result of them. But they have not proved sufficient to reverse divergence in the eurozone, which is what we need to do to deliver real economic dynamism. That requires a deep reform of our Economic and Monetary Union. We need a governance architecture and tools that we do not have at our disposal today, tools that

actively foster convergence within the eurozone and allow us to act in the general interest.

Concretely, I believe a more cohesive eurozone must rest on three pillars:

- **First, a fully fledged Banking Union**, to ensure that the banking sector in the eurozone is reliable and that non-viable banks are resolved without recourse to taxpayers' money and with minimal impact on the real economy. Work is ongoing with Member States on further risk-reduction and risk-sharing measures to strengthen the Banking Union. It is slow and it is painful, because striking the right balance between responsibility and solidarity is a challenge, as always in the EU.
- **Second, stabilization and convergence tools.** We cannot just sit and wait and pray for convergence to happen in the long run. If it is not happening, then let's make it happen. And the sooner, the better! We all know what the answer is: a fiscal capacity for the euro area. Work has been ongoing for years to refine the concept. The thinking today is much more mature than it was in the aftermath of the crisis. It is now a matter of political choice.
- **And third, we must enhance democratic accountability.** Decisions affecting the wellbeing of millions of Europeans

cannot be made behind closed doors, late at night, by a bunch of finance ministers. These decisions must be based on a still-to-be-created sense of general interest within the euro area. They should be subject to stronger democratic oversight and accountability mechanisms. The European Parliament cannot be an afterthought – it must be at the heart of efforts to strengthen the legitimacy of eurozone decision-making.

How is this going to play out? The Commission will present a reflection paper on deepening the Economic and Monetary Union at the end of May. It will build on the Five Presidents' Report of 2015 and will contain ambitious ideas. It will be guided by the principle that greater risk-sharing and greater risk-reduction must advance in parallel – indeed, they are two sides of the same coin. The fact that this is an election year must be seen as opening new possibilities: there could be a window of opportunity later this year to move forward decisively and I believe it is essential that we do so.

Delivering real economic dynamism via a deep reform of the economic governance of the Economic and Monetary Union will not be enough to contain populism, but it is part of the answer.

In addition, Europe will have to deliver better results on at least two fronts:

- **First, it must better protect its citizens.** And by that I do not mean economic protectionism. I mean that European citizens need to feel secure – and I am talking here about security in its simplest form. Europe cannot provide all the answers to the issues raised by terrorist attacks on our soil, or the refugee crisis, but we can provide some of them. And just as importantly, we must ensure that the benefits of globalization flow to all parts of society. Europeans feel vulnerable in a globalization process that does not distribute extra points of growth fairly.
- **Second, the EU must become more accessible and democratic as a response to those who falsely urge voters to “take back control”.** I have discussed democratic accountability in the context of the eurozone but this is a wider issue. Transparency, exemplarity, robust parliamentary oversight procedures must be developed, whether we are legislating on the single market or on agriculture.

Taken together, these elements may help fight the descent into populism in Europe, which is very much a political priority for the Commission and for me personally. Last month Geert

Wilders' anti-Islam Freedom Party was defeated by Dutch voters, who drew a line in the sand over the spread of populism in the Netherlands. But in France Marine Le Pen continues to score highly in the pre-election polls, while populist governments in Hungary or Poland repeatedly deviate from European values.

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Let me wrap up with a word on the US. The transatlantic relationship must remain strong. Both the US and the EU must remain committed to the multilateral system, to open economies and free trade, and to rejecting protectionism. That, too, should be part of our agenda for economic revitalization and fighting populism.

The new administration has yet to define precisely its policies in a post-campaign context. We in Europe are watching closely, with the same objective as before: finding common ground and room for cooperation. We are attached to a number of key concepts – open societies in open economies, multilateralism, inclusiveness, the fight against protectionism and climate change – and this will guide us as we engage constructively with the new administration here in Washington. I am confident that we will be able to find common ground.

Thank you.

CHECK AGAINST DELIVERY