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On behalf of the European Commission
Statement of Klaus Regling, Director General, on behalf of the European Commission to the International Monetary and Financial Committee
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The **global recovery** is broadening and gathering pace. Global growth should remain robust in 2004, supported by the impact of accommodative macroeconomic policies, buoyant world trade, favourable financial conditions, positive wealth effects, and a return of confidence. On the downside, global imbalances remain a risk to the sustainability of global growth. A disorderly adjustment could lead to financial market volatility, with negative effects on growth. Large public deficits combined with important current account imbalances and inflationary pressures could also raise long term real interest rates, putting pressure on household balance sheets in advanced economies in which debt levels are at historically high levels and in some emerging market economies. Heightened geopolitical uncertainties and oil prices also present a downside risk to the outlook. For a sustainable recovery, countries need to pursue sound policies with due attention devoted to the long-term sustainability of public finances. Structural reform has a key role to play in raising potential growth.

Recovery in the **euro area** is set to gather further momentum in 2004, on the back of strengthened global growth and trade, and returning confidence. The recently published European Commission Spring forecasts project a rebound of growth in 2004 of 1.7% for the euro area, and 2% for the EU. The recovery should be underpinned by increasing investment expenditure, aided by a gradual pick up in private consumption. The lagged effect of the euro appreciation and weak domestic price pressures should help keep inflation below an annual average of 2% in both 2004 and 2005. The favourable inflation outlook should allow monetary policy to remain accommodative. On the downside, recent survey indicators suggest that consumers remain cautious over purchases of consumer durables. A renewed sharp appreciation in the euro exchange rate could also undermine activity in the manufacturing sector, particularly in countries which are more dependant on external demand to generate growth.

Now that prospects have improved, the opportunity to speed up the necessary fiscal consolidation should be seized, as agreed under the Stability and Growth Pact (SGP), the EU fiscal policy framework. Reaching or maintaining sound budgetary positions is a necessary basis for realising the EU growth potential. Member States must ensure that they meet their commitments for budgetary consolidation. This is all the more relevant in light of the need to ensure long-term sustainability because of the budgetary challenge of ageing populations. The two key rules of the SGP, to run a balanced budget on average over the cycle, and to not breach the 3% of GDP ceiling; combine short-term flexibility with credible medium-term adjustment; they would enable countries to prepare for long-term budgetary challenges.

A faster pace of structural reform is crucial for creating a more dynamic European economy, and increasing potential growth, as envisaged by the “Lisbon strategy”. Progress is still insufficient to achieve the agreed objectives. EU Member States should take advantage of the economic recovery and the dynamics of EU enlargement to give fresh impetus to the Lisbon strategy, in particular, focusing on improving investment in networks and knowledge, strengthening competitiveness in industry and services, and promoting active ageing. The mid-term review of the Lisbon strategy this year should aim to improve the implementation record, and provide a fresh impetus to the strategy.

Further progress has been made towards the creation of an integrated and efficient EU financial market. This should help to raise EU growth potential by improving the allocation of capital, enhancing productivity and broadening opportunities for risk sharing. Financial integration has
accelerated markedly with the introduction of the euro, which has eliminated exchange risk in financial flows among the majority of Member States. Financial integration has been further enhanced by implementation of the Financial Services Action Plan (FSAP), which is on track for completion by the deadline of 2005. For the next phase of the integration process, the Commission has launched an assessment of the state of integration of EU financial markets, to identify successes and failures of the EU legislative framework after implementation of the FSAP. This assessment will form the basis of new Commission proposals on financial integration in 2005.

The **United States** is growing briskly, fuelled by expansionary fiscal policy and a very accommodative monetary policy. Consumer spending continues to advance strongly, and business equipment investment has rebounded. Robust productivity growth held back a recovery in employment for a protracted period, but the labour market has lately shown promising signs of strengthening. Employment growth should help to sustain the current expansion, which also provides an opportunity for shifting macro-economic policies towards a more neutral stance. Otherwise, the current account deficit and fiscal deficit are a cause of concern for the sustainability of the recovery.

Economic growth in **Japan** has continued to surprise on the upside. Japan is benefiting strongly from the dynamism of its Asian neighbours, and the initial export-led recovery is permeating through the rest of the economy. Deflationary pressures are slowly abating and could soon come to an end, if growth remains strong. To maintain the growth momentum, the authorities must press ahead with structural reforms, in particular to restore the health of the banking and corporate sectors. Another pressing challenge is to put the government finances onto a more sustainable footing.

The EU **enlargement** to ten new Member States on May 1 is an historic event. Never have so many countries entered the Union at the same time. Many of the new Member States have undergone a radical transition process. The new Member States are already benefitting from market integration and interest rate convergence, as reflected by robust growth in 2003. However, catching up with EU income levels will need to be supported by continued structural reforms and stability-oriented economic policies. Upon accession, the new Member States will become subject to the SGP. In light of the high deficits in some of these countries, an appropriate time path will need to be found to reconcile the speed of budgetary consolidation with the necessary public investments to improve structural and human capital and to adapt to EU standards. After fulfilling the necessary conditions, the new Member States will eventually adopt the euro. As part of this process, the new Member States are expected to join the exchange rate mechanism (ERM II) some time after accession. Entry immediately upon accession may not necessarily be an optimal strategy, especially if major structural adjustments are still required, if inflation has not yet been brought down sufficiently, or if fiscal policy imbalances hamper macroeconomic stability. For some countries, it may be desirable for the length of ERM II participation to exceed the required minimum period of two years.

The EU will continue to expand. Accession negotiations with Bulgaria and Romania are advancing towards the goal of accession by 2007. In December 2004, the European Council will judge Turkey’s compliance with the political criteria for accession. In the event of a positive decision, accession negotiations with Turkey will commence. All three candidate countries have made progress in stabilising their economies and implementing structural reforms. They have thereby enhanced the functioning of their market mechanisms and their competitiveness, with a view to joining the EU Single Market. The Commission also welcomes the progress made by the **Western Balkans** countries with economic stabilisation and structural reform, which have contributed to sustained GDP growth over the last four years. Peace and a democratic settlement
of remaining tensions in the region are of paramount importance for this process to continue and for Western Balkans countries to reap the success of all past efforts. Economic growth is expected to be led by SME development and FDI, which will require a functioning judiciary system to ensure the enforcement of law, and thereby overcome the impediments to a more dynamic business environment. On 20 April, the Commission adopted its opinion on Croatia’s application for accession. It concluded that the country fulfils the political criteria for accession, that it is a functioning market economy, and that it might be sufficiently competitive over the medium term, provided that the country addresses remaining difficulties. The former Yugoslav Republic of Macedonia submitted its application very recently.

Enlargement will also widen opportunities for developing closer links between the enlarged EU and its new neighbours in Eastern Europe and the Mediterranean regions. The European Neighbourhood Policy (ENP) launched in March 2003 is geared towards sharing the benefits of the 2004 EU enlargement with neighbouring countries in strengthening stability, security and well-being for all concerned. It aims to prevent the creation of new dividing lines between the EU and its new neighbours, and to enable them to participate fully in the EU internal market. Under the ENP, with the aim of promoting economic growth in the partner countries, the EU is committed to develop policies and to make more efficient use of existing programmes and financial instruments, including the extension of the EIB lending to the Union’s Eastern Partners and the EIB Facility for Euro-Mediterranean Investment and Partnership (FEMIP), as well as to develop new mechanisms, such as the future European Neighbourhood Instrument.

In Latin America, economic activity continues to recover, supported by competitive exchange rates, stronger world demand and improved investor sentiment towards the region. The Commission notes the improved macroeconomic performance shown by Argentina, and welcomes the efforts to advance the debt negotiations with private creditors. Significant progress has been made towards an EU-Mercosur Association Agreement, since the re-launch of the negotiations in November 2003. The aim is to complete the negotiations by end-2004.

EC development policy is committed to poverty eradication in developing countries, notably by promoting sustainable development, and their full integration into the global economy. The Commission continues to monitor progress on the EU’s Monterrey commitments. The 15 Member States have committed to increase official development assistance to 0.39% of GNP by 2006; on current trends, they could exceed this target. The EC has taken steps towards further untangling Community aid, and continues to advocate complementarity, donor co-ordination and coherence. The EU also remains committed to the Poverty Reduction Strategy Paper (PRSP) approach. The EC supports the Heavily Indebted Poor Countries (HIPC) Initiative, and has pledged more than €1.6 billion, in addition to contributions from individual EU Member States. However, the participation of all creditors is crucial. The Commission calls on those not yet participating to do so.

The top EC trade policy priority remains the completion of the Doha Development Agenda (DDA). Further multilateral trade liberalisation underpinned by a strong rules-based multilateral trading system will bring forth significant global economic benefits, and has a key role to play in supporting the integration of developing countries into the global economy. Following the setback in Cancun, the negotiations are now in better shape, as witnessed by the unanimous support of WTO members for re-launching the negotiations at the General Council in December 2003. WTO members must aim to agree at the earliest opportunity what should have been agreed in Cancun – notably, on framework modalities on agricultural and non-agricultural market access, on special and differential treatment for developing countries, and on how to deal with the Singapore Issues (investment, competition, trade facilitation and government procurement). The
Commission welcomes IMF efforts to support the DDA, in particular, the recent Board approval of a new Trade Integration Mechanism.

Combating the financing of terrorism continues to be a key EU priority, and more poignantly so in light of the tragic events of March 11. Substantial progress has already been made, but efforts must continue to ensure common application of international standards. We therefore welcome the recent decisions by the Boards of the IMF and World Bank to make the assessment of compliance with international standards for fighting money laundering and terrorist financing a permanent part of their surveillance procedures, and to step up technical assistance. In the EU, current efforts include a third Money Laundering Directive designed to implement the revised Financial Action Task Force (FATF) recommendations, and assistance to help third countries enhance their capacity to combat financial abuses. In March 2004, the European Council urged Member States to implement fully, and without delay, directives and framework decisions on money laundering and freezing property, as well as the UN Convention for the Suppression of the Financing of Terrorism. Co-operation between national authorities will be intensified. The Commission also acknowledges the potentially significant role of money remittances. As part of the work towards a single European payments area and control of cash movements at EU external borders, the Commission is giving due consideration to this issue.

While considerable progress has been made to adapt and broaden the coverage and transparency of IMF surveillance, sustained efforts are needed, with greater attention to financial vulnerabilities and balance sheets, and the regional aspects of surveillance. The Commission would welcome a further strengthening of the signalling role of surveillance, in particular through precautionary arrangements. There has been substantial progress with respect to the use of Collective Action Clauses (CACs) in international sovereign bond markets, and the Commission will do the same as EU Members States by incorporating CACs into the Communities’ international bonds. The Commission would also welcome faster progress on developing a voluntary Code of Conduct for creditor-debtor relations. But improving the crisis resolution framework also calls for further work on some of the features of the Sovereign Debt Restructuring Mechanism (SDRM), such as the aggregation of claims and treatment of the debt stock.