"Economic and political challenges for Europe"

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Ladies and gentlemen,

It is a pleasure to be here, in the heart of Berlin and at such a prestigious institution of higher learning. I would especially like to thank Professor Ingolf Pernice and the Walter Hallstein Institute for European Constitutional Law for the invitation to this distinguished event series.

An ardent advocate of science and enlightenment, Wilhelm von Humboldt wrote a short treatise on government in the spring of 1792. In one passage, he remarked that during the past year Europe had "*enjoyed the fruits of peace, but not a spirit of peacefulness*". Only one month later, war broke out again in Europe, as it would on too many occasions in the following centuries.

It is tempting to conclude today that the continent has forever surpassed a long era of conflict. But not far from where we are right now, remainders of the wall that once divided Germany and Europe serve as a stark reminder that peace and unity in Europe are not inevitable byproducts of the passage of time. They are the results of conscious and concrete political efforts – many of them recent in historical perspective – which need to be maintained and intensified if we want to assure a secure and prosperous future.

This is why I would like to take the opportunity tonight to explain our concrete efforts to support the economic recovery, the creation of jobs and to achieve broadly shared prosperity for the citizens of Europe. The stakes of these efforts go well beyond economics, however.

After years of prolonged crisis, the voices of populism and extremism have become louder in many parts of our continent. Fuelled by frustration about their economic situation and doubts about their future, some Europeans withdraw from the political process. There is a real risk that citizens and member states will fall back into negative stereotypes about each other and turn inward for solutions.

Here in Germany, the effects of the crisis are less pronounced and less visible than elsewhere. Employment is at historically high levels. The last years have seen decent wage growth. Youth unemployment is relatively low, in part thanks to an effective dual education and vocational training system.

But across Europe, citizens face tremendous economic insecurity. Today, about 24 million people are unemployed in the European Union. Seven million of them have been without work for two years or more. For young Europeans, the slow speed of the recovery has been especially disappointing. Over 20% of Europe's young people are looking for a job. This deprivation of professional experience and opportunity will make itself felt in their careers for decades to come.

If we fail to deliver significant economic improvements, we stand to lose the support of a whole generation of young Europeans. I have no doubt that the consequences would be calamitous.

The crisis and the beginning of the recovery

Before the crisis, European households and governments took on unsustainable amounts of debt for over a decade. Private credit boomed in many Member States. Often, it flowed not into productive investment but into the housing market, spurring construction and raising wages. Employment boosts driven by credit concealed that structural challenges, many of them longstanding, were becoming more important, and that competitiveness eroded.

At the same time, interest rates for sovereign debt were low, inciting governments across Europe to use debt instead of tax revenues to finance their outlays.

While seemingly sustainable in good times, this debt became an unbearable burden when the global economic downturn struck. After asset prices tanked, households and private businesses were excessively indebted. And with tax receipts evaporating, expenditures ballooning and capital markets deeply strained, investors began to worry about the risks inherent in sovereign debt.

Against the backdrop of these worries and the market developments they entailed, fiscal policy, which could have otherwise helped cushion the crisis' shock, was under consolidation pressure. As banks repaired their balance sheets by deleveraging and cutting loan activities, fiscal consolidation weighed on growth and employment.

As a consequence of these different factors, while unemployment in the United States has declined slowly but steadily since the crisis, Europe went into a second recession and continued losing jobs, especially in construction and industry.

It is in this context that euro area Member States stepped in to help the most hard-hit economies – Greece, Ireland, , Portugal, Spain and Cyprus – who had lost access to debt markets, or needed support for their banking sector, in order to give them the necessary time to adjust and stabilize their economies. These interventions have – on the whole – been successful. The programmes in Ireland, Spain and Portugal have been concluded. These countries have made considerable reform progress and are able to borrow on the markets again, even at record low rates. Cyprus is on the right track as well. In Greece, the new government has committed to a continuation of reforms while respecting fiscal commitments.

Important advances to prevent crises and reduce their consequences have also been made at the European level over the past few years. European banking union promotes a healthy and robust financial sector. The European Stability Mechanism safeguards Member States in financial distress.

Still, the long-term economic and social implications of the crisis are hard to overstate. Many countries have experienced little or no growth not just over a few years, but over the past decade.

In 2014, we saw the beginnings of a fragile and uneven recovery. In the short term, several factors point to an acceleration of this positive trend.

First, the drastic decrease in the price of oil is supporting the recovery. Lower energy bills will help increase domestic consumption and decrease the costs of production for businesses.

Second, decisive monetary policy steps taken by the European Central Bank are helping to combat deflationary tendencies which would cause a major risk to the economic rebound.

Third, the sustained depreciation of the euro enhances the competitiveness of producers in the eurozone, boosting exports.

As a result, the short-term economic outlook is improving. The European Commission currently expects economic growth to reach 1.7% in the EU and 1.3% in the eurozone in 2015, followed by further increases in 2016. We also expect the distribution of growth across Member States to broaden.

However, if not supported by further policy changes that enable long-term prosperity, this growth impulse risks being of a fragile and temporary nature given tremendous reform needs, low investment and uneven fiscal consolidation successes.

The paradox of continuing European integration

Ladies and gentlemen,

Europe also faces momentous political challenges both externally and internally.

Externally, the events of the past year have demonstrated that our values and the international security order we are embedded in are under pressure from different sides.

In Ukraine, people are losing their lives in conflict after demanding a political reorientation of their country. The situation there demands that we do everything we can to avoid further conflict and stabilise the Ukrainian economy. But it also shows that we cannot take national sovereignty for granted on our own continent, and that the need to defend our values is not a thing of the past.

In North Africa, instability and economic deprivation play into the hands of reckless human traffickers whose activities risk people's lives in the Mediterranean. We need to intensify collaboration with countries in the region to durably improve their prospects and stop this humanitarian crisis.

In Syria and Iraq, the terrorist group ISIS is spreading terror and death among people of all faiths. Its agents are not religious leaders but terrorists seeking religious legitimacy. And their attacks are directed not only or primarily against our values and history, but against that of any civilized people. As the shocking atrocities in Paris and Copenhagen have shown, the terrorist threat to our values and security remains acute.

All of these challenges concern the European Union as a whole and demand determined European responses.

Meanwhile, internally, relations between Member States have at times become more tense. Trust between key stakeholders is waning, particularly in the area of economic policy. And there is a real danger of falling back into the trap of old stereotypes.

Two developments play an important role in this context.

First, the economic crisis has introduced an element of asymmetry between Member States. While member states participate in a union of equals, the concepts of "debtor countries" and "creditor countries" have complicated matters. They tend to stigmatise populations, provide fertile breeding ground for populist simplifications, and make collaboration more difficult.

Second, and more fundamentally, the crisis has called into question the European promise of welfare gains and economic convergence. The legitimacy of European integration – besides our commonly held values, and the protection from foreign threats – has also hinged on the promise that citizens stand to benefit economically from the process. While the European Union is now generating more economic benefits to European citizens than at any other point in its history, it is easy to gloss over these advantages and take them for granted. Against the background of difficult yet indispensable adjustment needs, some erroneously depict Europe as offering not benefits and welfare gains but budget cuts and sacrifices.

The conjunction of these dynamics within and between member states gives rise to a curious paradox. While more Europe is sorely needed, the readiness to take additional steps towards a more viable political union is faltering.

We would need more integrated capital markets to share risks, but it is it is a challenge to overcome inertia and scepticism.

We would need to agree on fairer rules for the taxation of corporate profits, but it is not easy to overcome the unanimity rule and find consensus on the form that this could take.

We would need deeper fiscal coordination to absorb economic shocks, but worries about fiscal sovereignty make the matter very complex.

We would need a European defence force to effectively dissuade potential threats and realise economies of scale, but traditions and a lack of boldness hold our progress back.

Preconditions for addressing the paradox

Overcoming this situation will require resolve and trust.

We need resolve, because it is of the essence to realise that the cost of doing nothing now would be exorbitant. With external challenges looming, downside risks to our economies remaining important and monetary union not fully achieved, we cannot waver in our commitment to strive for deeper integration and build a more stable union.

We need trust, because it is the fundamental condition for effectively advancing our common goals. Germany and France, but also the Commission, have a crucial role to play in this context. The historical friendship between Germany and France has for decades been, and remains until today, an essential driver of the European project.

The latest joint efforts by Chancellor Merkel and President Hollande to bring the adverse parties from Kiev and Moscow back to the negotiation table in Minsk are a testimony to this. Yet, in the area of economics and public finance, the mutual perception is too often coloured by misconceptions and stereotypes.

While many French admire Germany for its economic strength and the quality of its engineers, many also express frustration about Germany not doing enough to stimulate growth in the eurozone. On the other side of the Rhine, many Germans see France as unable to reform. This is not a good basis for trust-based cooperation and effective financial and economic policy coordination in the EU. Friends can – and indeed should – be able to talk to each other with frankness. But they must do so with respect, and not in a condescending or patronising manner.

The Commission has a central role to play in building trust by bringing evidence and analytical objectivity to the table.

Allow me to add a word on the European Central Bank. The ECB acts in full independence, of course. And I will not comment on the substance of its monetary policy decisions. But I am concerned to see to what extent public discourse about monetary policy is sometimes couched in terms of national interests.

Let me stress that, throughout the crisis, the ECB has taken important decisions in the interests of the euro area as a whole and within its mandate. This is the case also for the recent launch of the Public Sector Purchase Programme.

Supportive monetary policy is an important element in the policy mix needed at this juncture. Let us not forget that inflation in the euro area has been very low for almost two years and turned negative since December last year. This is not a healthy development. The low level of inflation is mainly due to a fall in oil prices. This provides a welcome shot in the arm of the economy. But low or negative inflation also makes it harder to drive down nominal debt and slows down economic adjustment. The ECB's measures should help bring inflation closer to the ECB's target, facilitate the reduction of private sector debt overhang and stimulate credit expansion.

But let me make clear that I agree with President Draghi: monetary policy cannot fix structural weaknesses. This is why we must continue to advance reforms in Europe, some of which have been long overdue.

The economic policy agenda

Ladies and gentlemen,

The new Commission has taken office five months ago. It has taken office in difficult times. But it has also taken office with a clear and straightforward agenda. As President Juncker has made clear, our "number one priority and the connecting thread running through each and every proposal will be getting Europe growing again and getting people back to work".

In the short term, our actions are guided by a three-pillar approach: (1) investments, (2) reforms and (3) fiscal responsibility.

First, we will invest to support the nascent European economic recovery.

Of course, economic conditions are highly heterogeneous across the European Union. But in the aggregate, boosting targeted investment is essential to avoid a long period of stagnation. Member States need to play their part by doing all that is in their power to use their funds effectively and frontload productive public investments.

The Investment Plan for Europe presented by President Juncker is designed to mobilise investments of over 315 billion euros to support the recovery. It consists of three elements: a financing strand, in particular the creation of a new European Fund for Strategic Investments, an information strand with the establishment of a transparent project pipeline, and a regulatory strand to make Europe more attractive for investments.

The proposed measures should significantly boost the EU's GDP over the next three years.

It is important for the additional investment to become effective quickly. Therefore, our timetable is ambitious. Last week, the Council has agreed on proposed legislation, meaning the proposal can now advance through the European Parliament and the Fund can hopefully be operational by mid-2015.

Reforms constitute the second pillar. We will continue to vigorously support reform efforts that need to be undertaken by Member States to improve regulatory policies, facilitate investment and job creation and unlock our long-term growth potential. Ambitious implementation of labour market reforms across Member States will not only help increase productivity, but also ensure that employment can rebound more quickly as the business cycle advances. Successful reforms in Portugal and Spain are testimony to this.

The Commission supports reform efforts by offering advice and incentives to Member States. The European Semester, which has become an important framework for delivering reforms, has recently been streamlined and will continue to play an important role in economic policy coordination. Moreover, our recent communication on the Stability and Growth Pact set out how we it can be applied to more effectively and encourage Member States to undertake ambitious reforms.

I want to underline that the goal of structural reforms is to make sure that the recovery results in employment growth and prosperity that is broadly shared. Overly rigid labour markets widen the rift between the employed and the unemployed and inhibit employment growth even in good times. It is therefore precisely in order to support inclusion and participation in labour market opportunities that we need to do more to reform our economies.

The third pillar is fiscal responsibility. Following years of very serious efforts to restore control of public finances, we need to remain unwavering in our commitment to fiscal prudence. If we are to avoid the mistakes of the past, deficit and debt levels need to be maintained on a sustainable path.

The current aggregate fiscal stance in the eurozone is broadly neutral, meaning that structural government deficits are stable. The European Commission is of the view that this is appropriate in light of the feeble recovery.

Some Member States need to increase their efforts at fiscal consolidation. As stated in our recent country report, the economic challenges for France are substantial: the dynamics of public debt must be reversed. And structural reforms are required to strengthen competitiveness, improve the functioning of the labour market and modernise public administration. But we also see that the government is moving in the right direction. The Commission has taken a number of decisions last month to further encourage the French government to speed up and deepen reform. And the Ecofin Council last week followed our recommendation to France, urging new decisive measures to correct the excessive budget deficit by 2017, with demanding milestones

Other Member States have fiscal leeway to make productive investments that would sustain the recovery and increase their long-term growth potential. Germany is currently the motor of the European economy. The German people are rightly proud of their export success, from which all of Europe benefits. The Commission in no way wishes to undermine that success. But we are concerned about the medium-term outlook for potential growth and it is our view that there is some space for Germany to do more now to support demand, and in particular investment.

This does not mean calling into question Germany's commitment to sound fiscal policies. It means using the fiscal space that is available to ensure that Germany meets its investment needs for the future. And avoiding an erosion of German growth potential is in the interests of German citizens first and foremost.

In our country report for Germany we present budgetary projections. They indicate scope for more expansionary fiscal policy of at least 0.5% of GDP every year between now and 2018. This would be fully within the rules of the national debt break and the European Stability and Growth Pact.

Sustainable public finances also depend crucially on an effective and transparent tax system. At the European level, we have recently introduced measures to combat tax evasion, and I will present important new proposals for reinforcing fiscal transparency this Wednesday.

Together, these three pillars will ensure that the risk of stagnation is avoided and that the benefits of the recovery are broadly shared.

The long-run perspective

Ladies and Gentlemen,

Durably enhancing our union also demands a long-run perspective on which avenues to take.

In this vein, the new Commission has decided to undertake new initiatives to deepen the single market. As laid down in the Commission Work Programme, we will advance efforts to harmonise and integrate digital, telecommunication, energy and services markets as well as capital markets. These projects, when completed, will support growth and competitiveness.

And precisely at the time when we are slowly emerging from the crisis, we also need to think and discuss further about deepening our monetary union. It is by now widely accepted that part of the eurozone's vulnerability in times of crisis was due to insufficient financial and fiscal integration within the currency union. Strengthening it is likely to require several elements.

We will need to streamline and integrate economic and budgetary coordination processes, while strengthening the tools available to encourage reforms in member states.

We will need to move towards better adjustment mechanisms in the eurozone, potentially in the form of a euro area fiscal capacity, while avoiding moral hazard and acknowledging the importance of fiscal subsidiarity.

And we will need to do so while doing our utmost to improve democratic legitimacy and accountability, for example by involving the European Parliament and national parliaments.

A new report by the presidents of the Commission, the Eurogroup, the ECB and the European Council will provide new impulses in this direction in June.

Conclusion

Ladies and gentlemen,

I would like to bring this address to a close by expressing my belief that Europe can emerge strengthened from this recovery. Together, we will put the right measures in place to support the economic rebound and regain our prosperity, and we will do so on the basis of a strong political consensus.

Building political consensus across Europe is always challenging, and it will continue to be. The European Union does not grow closer automatically.

As the first President of the European Commission, Walter Hallstein, once remarked: *"The essence of politics is choice. For this reason, I should not like to leave the impression that because the logic of economic integration is compelling and inexorable, its consequences can be put into practice without making a political choice and a number of difficult political decisions. Such choice and such decisions were needed for the process of European integration to begin. In order that it may continue, they are needed at every step of the way."*

Many of you in this room were born after the fall of the Berlin Wall. You have witnessed a period of peace and continuous European integration. I would like to invite you to remember that this achievement is neither obvious nor spontaneous, and to use your fresh ideas and energy to contribute to our common project.

Thank you very much.