

TOWARD A STRONGER EUROPE IN THE GLOBAL ECONOMY

Horst Köhler¹

I am very pleased to be here today and address the East-West Conference for the second time. My first visit was in 2000 when the theme of the conference was “Completing Transition”. Now, a mere three years later, the word “transition” no longer appears in the conference title. Mission accomplished? I do not think so, and I hope that the conference will be an opportunity to reflect on a new transition: a transition to a Europe that can make a strong contribution to a growing world economy and prosperity for all.

■ The Global Economy ■

The global economic outlook is improving. Led by the United States, prospects for a recovery are fining in the advanced economies. This is good news for emerging market and developing country economies as well, which have also benefited from a supportive financial market environment. But we know that risks remain. Chief among these risks is the excessive dependence of the world economy on growth in the United States and the resulting global current account imbalances. Resolving these imbalances in an orderly manner must be the primary objective of international economic policy. And this requires a cooperative approach involving all major countries and regions.

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- In the **United States**, significant monetary and fiscal stimulus is in the pipeline. But while fiscal policy has provided short-term support to the economy, going forward it will be critical to restore medium-term fiscal balance.
- In the **euro area**, indications of an economic recovery are still more tentative. But there are increasing signs of returning confidence and it is encouraging that several euro area economies have initiated long-overdue structural reforms, buoying expectations.
- In **Japan**, recent data point to a much hoped-for firming of the short-term economic outlook. And structural reforms in the corporate and financial sectors must continue to be pursued vigorously to raise longer-term growth prospects.

¹ Horst Köhler is Managing Director of the International Monetary Fund. The following is a speech he gave at the East-West Conference in Vienna on 2 November 2003.

- In **emerging market economies**, sound economic policies and structural reforms are bearing fruit in several countries. But vulnerabilities bear watching, particularly as a result of persistent high levels of public debt. Current favorable financing conditions must be seized as an opportunity to reduce these vulnerabilities. And where reserve accumulation has been rapid and current account surpluses large, allowing greater exchange rate flexibility would be helpful, both domestically and globally.

■ Policy Priorities for a Larger and ■ Stronger Europe

Against this global background, what should be the **policy priorities for Europe**? On the threshold of the enlargement of the EU, the destinies of all the European economies are becoming ever more intertwined. I am confident that enlargement will bring significant benefits for old and new members alike, not least through the expansion of the internal market. Moreover, for the accession countries, closer political and economic integration within Europe offers new sources of capital and technology. And for the existing EU members, the new members will bring fresh perspectives and provide welcome impetus to competition. But while convergence and the dynamism of its new young market economies will boost economic performance in the accession countries for some time to come, the medium-term challenge that all European countries face is the same: how to remain competitive in the global economy, how to continue to improve the standard of living for their populations, and how to ensure that the benefits from growth are spread as widely as possible.

There is no need for undue pessimism. Europe continues to possess significant economic strengths, including good public infrastructure, a well-educated and trained work force, and high domestic savings rates coupled with financial systems that are capable of channeling resources to productive investment.

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And in numerous areas, European companies remain world leaders, competing on quality and innovation. But globalisation and the accelerated integration of world markets requires always remaining in motion: ie the economic and political ability to adapt to constant change. New growth hubs are emerging in Asia, where growth has outpaced Europe by 5 percentage points per year over the past decade; and, according to our World Economic Outlook, will continue to do so in the coming years. And I expect the United States to return to strong growth, driven not least by a remarkable capacity for technological

innovation. Therefore, in my view a larger Europe must also become a stronger Europe, which is outward-looking and capable of competing successfully in the global economy.

In **Western Europe**, there has been no lack of debate on what needs to be done. In my view, the EU's Lisbon Agenda correctly identifies the key challenges: how to improve incentives

to work, how to foster innovation through better education and training systems, and how to encourage the cutting-edge research and development needed to remain competitive. Meeting these challenges requires tackling the root causes of anemic growth through a vigorous acceleration of structural reforms. These relate especially to the labour market, which is also at the core of Western Europe's deep-seated fiscal problems. Different countries and regions maintain differing approaches to labour markets, and rightly so. But benefit systems in Europe are too generous and taxes too high to expect vibrant, employment-rich growth over the medium term. I welcome the new reform momentum which is evident in Germany's Agenda 2010 and in the initiation of reforms in a number of other countries, including the welcome progress on pension reform in France, Italy, and not least here in Austria. But there is no doubt that reforms will need to be deepened and broadened if they are to deliver the expected dividends for growth and employment over the medium term.

The **Central European and Baltic countries** poised for EU accession can rightfully look back to significant economic achievements over the past decade. Macroeconomic stabilisation has been followed by comprehensive economic restructuring, which is creating increasingly competitive economies, not least thanks to continued high inflows of foreign direct investment. But this is not the time to relax. Large current account and fiscal imbalances in many countries illustrate their remaining vulnerabilities, and in most countries the medium and long-term pressures on public resources as a result of aging populations rival those in Western Europe. Financial sectors also remain underdeveloped in many countries, and institutional frameworks, especially predictable and well-enforced legal and regulatory systems, still fall short of international best practice. Tackling these issues decisively will ensure that Central Europe and the Baltics can continue to be centers of investment and job creation in Europe for many years to come.

As Europe becomes larger, it will be critical that it not retreat behind its expanded borders. Over the past half-century, building the European Union has brought peace and unprecedented prosperity to the people of Western Europe. I am confident that enlargement, which will create an economic area of some 450 million people accounting for well over a quarter of world GDP, holds tremendous promise for both the current and the new members of the EU. But ensuring that Europe heads to a good future will require an outward-looking strategy, embracing the opportunities of globalisation, while maintaining its own identity. For the Balkans, a clear perspective of, and commitment to future EU membership is a key to lasting stability and promoting prosperity. The Stability and Association Agreements with the Western Balkans are already providing momentum and a sense of direction to policymakers and the public. But the EU can help in many other ways: I support the recent "Wider Europe" initiative of the EU, which offers a prospect of closer economic ties for the EU's new Eastern neighbours over the medium term, including improved market access to the exports from its new neighbours. I also hope that the EU's reform of its agricultural policy – a key element for a successful conclusion of the Doha Round – will help in boosting trade with this region.

Ensuring that Europe heads to a good future will require an outward-looking strategy.

■ The Role of the IMF in a Larger Europe ■

The IMF's role in Europe is evolving in tandem with Europe's further economic integration. Our focus is increasingly on cross-border issues as much as on the policies of individual countries.

- In our **ongoing surveillance**, we will continue to focus on the key issues facing Europe, including establishing appropriate medium-term fiscal frameworks, bringing long-run considerations – notably population aging – to bear on current fiscal plans, and implementing structural reforms needed to raise its long-term growth potential. And for the new members, in the run-up to membership of the euro area, the conduct of monetary and exchange rate policy will likely pose some difficult challenges. The appropriate strategy and timing of the adoption of the euro is likely to differ according to individual country circumstances. But achieving durable macroeconomic stability is surely a prerequisite. I look forward to an in-depth debate of this question, including at the conference that the IMF will be hosting with the Czech National Bank early next year.
- Of equal importance, especially in the new and prospective members of the EU, will be our work on **transparency and international standards and codes**. Meeting international standards of best practice is a critical building block in strengthening business confidence and fostering investment and job creation. A key focus of our financial sector assessment programme will remain on financial sector reforms, particularly to improve risk assessment and financial supervision. Fiscal transparency, including the role of audit agencies in strengthening governance of public finances and reducing corruption, will also continue to be an important part of our work in many countries. And improving the quality and transparency in the dissemination of economic data remains key to strengthening domestic economic management and promoting our members' integration in international financial markets. In all these areas, we will continue our fruitful collaboration with the European Commission and the European Central Bank.

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I am optimistic that a larger Europe can also be a stronger Europe. The progressive economic integration of the countries of Central and Eastern Europe and the Baltics into the European Union is now bringing better jobs and long-awaited improvements in living standards to increasing parts of the population throughout the region.

But globalisation forces constant adaptation and change, as the spread of information, innovation and technical progress expands opportunities and markets for all countries. In 1950, Robert Schuman, one of the founding fathers of a united Europe said “Europe will not be made in one fell swoop or according to a single plan. It will be built through concrete achievements of de facto solidarity”. Now, at the beginning of the 21st century, it is again with concrete steps that a larger Europe can build its own future and be a force for prosperity world-wide.