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Statement by Commissioner Joaquin Almunia
On behalf of the European Commission

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In 2004, global growth reached its highest rate in 30 years. The expansion looks set to continue this year, albeit at a somewhat slower pace. The deceleration of economic activity in the **EU and the euro area** observed in the second half of last year was partly due to the increase in oil prices and the strength of the euro. It should be considered a temporary pause as growth is expected to return to potential in the course of this year. The consolidation of the recovery in the EU/euro area is projected to be driven by accelerating domestic demand, especially investment, while private consumption should pick up speed more gradually.

Benefiting from accession, **the new Member States** continued to enjoy strong growth, although they also felt the weakness of their main trading partner, the euro area, and the consequences of high oil prices. The process of catching-up with EU income levels continues, driven by considerable private and public investment, and with the support of EU funds. In order to sustain the favourable economic performance and tackle high unemployment in many of the new Member States, structural reform should continue and macroeconomic stability be preserved. The full integration of the new Member States in the EU multilateral surveillance process will help in this respect. Estonia, Lithuania and Slovenia have joined Denmark as members of the Exchange Rate Mechanism (ERM II), which aims at facilitating a smooth adoption of the single currency by members that fulfil the necessary conditions. For those new Member States that have not yet joined the mechanism, the prospect of doing so continues to catalyze reform efforts.

Macro-economic policies in the euro area need to continue to support a well-balanced economic expansion and the full realisation of the growth potential. The best contribution monetary policy can make to the achievement of this goal is to continue delivering price stability in the medium term. The monetary stance has remained supportive of economic growth, although the appreciation of the euro in the fourth quarter of 2004 had some tightening effects. Nominal and real short-term interest rates are still very low by historical standards, as the European Central Bank has left its policy rates unchanged since the summer of 2003.

During the initial years of EMU, not enough use was made of favourable economic circumstances to achieve significant budgetary consolidation. The current economic upswing should be used to consolidate public finances and reduce fiscal deficits which remain too high in a number of Member States. Well-designed budgetary consolidation can exert a positive influence on confidence regarding growth and employment prospects by addressing concerns about fiscal sustainability in light of ageing populations. When recently agreeing on amendments to the **Stability and Growth Pact**, Member States unanimously renewed their commitment to take the necessary budgetary action to achieve sound and stability-oriented budgetary policies. This compromise agreement presents a balanced package and removes the previous uncertainty about the interpretation of the EU rules. The Pact has been confirmed as a strong instrument to foster budgetary discipline and has been given new vigour.

The preventive arm of the Pact has been strengthened by ensuring that due attention is given to the fundamentals of fiscal sustainability when setting medium-term budgetary objectives.

The strengthened commitment by Member States to actively consolidate public finances under favourable economic conditions and the possibility for the Commission to act if this is not the case are particularly noteworthy in this respect. The new agreement also includes incentives for Member States to embark upon structural reforms. Changes to the corrective arm of the Pact will allow for the application of the rules to better reflect the economic realities in an enlarged EU of 25 Member States. Room for judgement is introduced in the excessive deficit procedure, but the 3 percent and 60 percent reference values for the deficit and the debt ratios remain the anchor of the system. Any excess of the deficit above the reference value that would not be small and temporary will be considered excessive by the Council. There will be no simple discounting of certain categories of public expenditure from the deficit calculations. Finally, Member States in excessive deficit will be requested to achieve a minimum annual budgetary effort of 0.5% of GDP.

Overall, there is renewed consensus on a revised set of rules with more economic rationale, allowing more ownership by Member States. The Commission will ensure a forceful implementation of the agreement and the impartial and equal application of the rules to all Member States.

Recognising the insufficient progress made in reaching the objectives of the **Lisbon agenda** on economic reform, this year's Spring European Council gave new impetus to the reform effort. To preserve the EU's model of sustainable development, the competitiveness of the Union must be strengthened and its economy must regain vitality. The renewed Lisbon strategy will therefore be built around three major priorities: (i) promoting knowledge and innovation as engines of sustainable growth; (ii) making the EU an attractive area in which to invest and work; (iii) fostering growth and employment to enhance social cohesion. To match goals with deeds, a number of areas for concrete actions have been identified, such as completing the internal market; boosting both public and private investment in R&D; improving the conditions for firms to innovate; improving the regulatory environment; continuing with labour market reform; and reforming social protection systems.

The expansion in the **United States** continues at a solid pace, somewhat above the long-term potential growth rate, based on strong household and business spending. Underlying inflation appears to remain contained although some measures of inflation have moved higher recently. It is now important to bring short-term interest rates towards a neutral level. It is also essential that public finances are brought back to a prudent medium-term course. The growing imbalances on the external accounts, and the way by which they will be corrected, continue to be a cause for concern.

Growth in **Japan** is expected to rebound somewhat in the first half of 2005. Government finances have now to be put onto a sustainable path. Furthermore, in order to increase Japan's potential growth rate, the on-going work on structural reforms need to be further broadened and deepened in a wide range of areas.

Buoyant **oil** demand and increased concerns about the ability of supply to keep up the pace have created a very tight market. To reduce vulnerability to oil market developments, there is an urgent need to make a concerted effort to enhance energy efficiency, remove barriers to investment in new capacity and improve the transparency of oil markets.

Regarding further **EU enlargement**, the process of Bulgaria's and Romania's accession to the European Union is well advanced. Accession negotiations with these countries were successfully closed in December last year. The signature of the Accession Treaty is foreseen for next April with possible accession by 1 January 2007, if preparations go well. Also last December, the European Council considered Turkey to sufficiently comply with the political criteria for accession and therefore decided to open accession negotiations with the country, which will start next October. All four candidate countries have continued to enjoy a favourable economic development and have made further progress with economic stabilisation and structural reform implementation. They have also enhanced the market mechanisms and the competitiveness of their economies, which, together with rising productivity levels and investment, contribute to a generally favourable economic outlook for these countries. Furthermore, the European Union fully and effectively supports the European perspective of the other Western Balkan countries.

The **European Neighbourhood Policy (ENP)** is a major policy priority in EU external relations. It aims at lifting the level of relations with our neighbouring countries from traditional trade and cooperation instruments toward closer integration. Progressive integration of these countries in EU economic structures, supported by increased EU financial assistance, should facilitate economic reforms and raise their growth and prosperity. ENP Action Plans were negotiated and concluded in 2004 with a first group of countries in both the Mediterranean region and Eastern Europe, and some have already entered into force. Preparations are also continuing to expand the ENP to include the three South Caucasus countries (Armenia, Azerbaijan and Georgia) and two additional Mediterranean partners (Lebanon and Egypt).

Many **Asian** economies saw a broad-based acceleration of growth momentum in 2004. The region is becoming a key engine of global growth. Although the **tsunami** catastrophe at the end of last year caused immeasurable human suffering, it is hoped that the negative macroeconomic consequences can be mitigated by the economic dynamism of the region and coordinated assistance from the global community. Considering the large number of donors and NGOs involved, plus the substantial amounts of funding available, the success of the operation crucially hinges upon the efforts being well co-ordinated. The European Commission contributes to this end by directing most of its assistance to multi-donor Trust Funds managed by the World Bank. As the largest group of donors to the tsunami reconstruction, the EU expects adequate representation in the governing bodies of these Trust Funds. At the Jakarta Donors' Conference in January 2005, the European Commission pledged 350 million euro for longer term reconstruction support. This has now been programmed and will enable assistance to focus not only on those countries most severely affected and most in need, namely Indonesia, Sri Lanka and the Maldives, but also on regional actions in areas such as environment (coastal zones) and deployment of early warning systems.

The Commission welcomes the strong economic performance in **Latin America,** but emphasises the importance of using this opportunity to press ahead with necessary fiscal consolidation and structural reform efforts. It also encourages Latin American countries to complement these efforts with policies aimed at enhancing social cohesion and deepening subregional integration.

EC development policy remains committed to poverty eradication in developing countries within the framework of the Millennium Development Goals (MDGs), notably by promoting sustainable development and integration into the global economy. Innovative financing mechanisms to finance the MDGs deserve careful attention, but should not distract from the primary task of increasing aid budgets directly. On current trends, the EU target of increasing ODA to 0.39% of GNI by 2006 could be exceeded. The Commission now proposes to set an

EU target of 0.56% for 2010. Although we welcome the two year extension of the HIPC sunset clause, we remain concerned that some post-conflict HIPCs may not be able to enter the initiative.

The Commission remains convinced of the immense importance of a successful conclusion of the current round of multilateral trade talks, the so-called **Doha Development Agenda (DDA)**. The achievement of an ambitious DDA outcome is crucial to enhancing global growth prospects, whilst also being key to supporting the continued integration of developing countries into the world economy, and to making further progress with poverty reduction. Indeed, delivering on the development dimension of this round of trade talks remains a prime objective. Now, in the run-up to the next WTO Ministerial Meeting in Hong Kong in December, there is an urgent need for continued international political commitment to the DDA, and for renewed momentum in the negotiations. The Commission urges all WTO members to demonstrate the flexibility and commitment necessary to make the DDA the success that it promises to be.

While considerable progress has been made to adapt and broaden the coverage and transparency of **IMF surveillance**, sustained efforts are needed to strengthen surveillance as an instrument of crisis prevention. The Commission welcomes ongoing efforts to further strengthen the signalling role of the IMF and the increased use of debt sustainability analysis. Besides the increasing use of Collective Action Clauses (CACs) in international sovereign bonds, a broad acceptance of the Principles for Stable Capital Flows and fair Debt Restructuring in Emerging Markets would contribute to improve the crisis resolution framework.