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The lecture by Finance Minister Jyrki Katainen at SAIIA Speakers Event 30.08.2010

The Global Economic Situation and the EU's Economic Reforms

Honourable Minister, Excellencies, other distinguished representatives of the South African government and foreign missions, ladies and gentlemen,

Let me express my delight to be here with you today. I want to thank the South African Institute of International Affairs for the opportunity to speak to you on this occasion. Taking into account the time limit I can touch upon only some topical issues. First I will make some notes concerning the EU's response to the global economic situation. Second, I will address economic developments in Finland. Third, I will raise some issues regarding main reform projects in the European Union. After that I will shortly discuss the position of the EU in the international climate change negotiations. Finally I will make some points regarding sustainable development and poverty reduction. At the end of my presentation, I would be happy to hear your comments and questions in order for us to have a two-way discussion on these issues.

EU Response to Global Economic Situation

Ladies and Gentlemen,

The European Union has responded to the fragile and impending economic situation with unforeseen determination. Those member-states with the largest public sector deficits and debt problems - Greece in the forefront - have adopted remarkable saving programs extending to several years ahead. The establishment of a 500 billion euro European Financial Stabilisation Facility and an additional 250 billion euro contribution from the IMF has guaranteed adequate liquidity for countries in the danger of sovereign insolvency. The European Central Bank has, exceptionally, started to buy government bonds of countries encountering problems.

The European Council decided in its last June meeting that European banks must make public the results of “stress tests” revealing their economic solvency. The results of these tests have revealed that as a whole the European banking sector is well financed to stand hard economic headwind. Indeed, only seven Spanish savings banks, one German Bank and one Greek Bank did not pass the criteria of the test.

I dare to say that in the financial markets, all these arrangements have significantly increased confidence in the ability of European countries encountering problems to look after their economies in the coming years.

Economic developments in Finland

Ladies and Gentlemen

Next I would like to say some words concerning economic developments in my country Finland. Finland entered the global crises in the second half of 2008 from a relatively strong position, having built up a substantial surplus in its current account and in the government finances. In early 2009 the major export industry branches of metal engineering, electronics and forestry, all experienced a particularly sharp drop in global demand. Resulting from that export volumes dropped by 25 per cent in 2009. As a consequence of this investment fell by 13 per cent and private consumption by 2 per cent. Unemployment rose to 8 per cent. Indeed, all these negative trends diminished the GDP by some 8 per cent, which was the largest decline in the Euro area.

In the government sector automatic stabilisers were allowed to operate fully and, in addition, around 3 per cent discretionary fiscal stimulus package was adopted for the years 2009 and 2010. This has helped to cushion the impact of the crises on the domestic market. Reflecting these measures general government fiscal balances have weakened by more than 6 per cent falling into a deficit of more than 2 per cent. The deficit is forecast to widen to more than 3 per cent this year. In 2011 the deficit will be diminished as economic growth accelerates and taxation is tightened. However, the public debt ratio will rise to 51 per cent of GDP. The Government is now finalising a concrete medium term fiscal policy package to get the public sector back on a sound footing.

In spite of an exceptionally rapid drop in GDP, the economy has maintained solid fundamentals and is relatively well placed to return to a growth path. Also the Finnish financial sector has remained on a solid footing throughout the crises. Exports are expected to recover after global economic recovery takes hold. Stronger contribution to growth is, however, hindered by the current economic structure with maturing electronics and forest industry sectors. Private consumption is forecast to return to a growth path this year and investment next year. Consequently, GDP is expected to increase by 1 ½ per cent in 2010 and 2 ½ per cent in 2011.

Economic policy coordination in the EU

Ladies and Gentlemen,

As noted above the financial and economic crisis has revealed clear weaknesses in the economic governance of the EU, in particular as regards budgetary and broader macroeconomic surveillance. Reinforcing economic policy coordination therefore constitutes a crucial and urgent priority.

The European Council, in last June, underlined that present rules on budgetary discipline must be fully implemented. As regards their strengthening, the Council agreed,

- to strengthen both the preventive and corrective arms of the European Stability and Growth Pact,
- to give, in budgetary surveillance, a much more prominent role to levels and evolutions of debt and overall sustainability, as originally foreseen in the Stability and Growth Pact,
- to present, in the context of the so called "European Semester", from 2011 onwards, Stability and Convergence Programmes for the upcoming years,
- to ensure that all EU Member States have national budgetary rules and medium term budgetary frameworks in line with the Stability and Growth Pact, and their effects should be assessed by the European Commission,
- to ensure the quality of statistical data, which is essential for a sound budgetary policy and budgetary surveillance.

As regards macro-economic surveillance, it was agreed to develop a scoreboard to better assess competitiveness developments and imbalances and allow for an early detection of unsustainable or dangerous trends. It was also agreed to develop an effective surveillance framework.

I think that these reforms will bring the public sectors of EU economies back on a sound footing. But, no doubt, the reforms must be strictly implemented and the recovery will take, in most cases, the whole decade ahead.

Financial Market situation in the EU

Ladies and Gentlemen,

As we all know, the financial crisis has also revealed several weaknesses in the crisis management of banks and in the functioning of financial regulation, supervision and infrastructure. The general target of the reform proposals on the table is to improve the stability of the financial system and increase the financial buffers to allow a response to possible future crises. Also the aim is that financial market actors participate in financing the costs of future crises.

In my view the EU should move forward swiftly with its agenda for improving financial supervision and regulation. It is very important that we have a coordinated approach to regulatory reform. We should avoid unilateral national actions in this field.

First, we have to complete our work regarding the EU's new supervisory architecture.

Second, it is necessary to strengthen the functioning of the derivatives markets. I would stress the importance of increasing transparency in these markets rather than imposing outright bans or prohibitions.

Third, we should consider ways how the sector itself could better contribute to financing the costs of financial crises. The first line of defence, where the sector is itself bearing the costs of risky investments, is the institutions' own capital. Therefore, we should keep in mind the importance of agreeing that banks are required to hold more, and better quality capital than what is the case under current rules.

Fourth, even stronger capital buffers will not be able ensure that no financial institution gets in trouble. Therefore, we need better and more predictable resolution mechanisms, whereby bank failures can be solved in an orderly manner without recourse to tax payer financing. To ensure this, we should agree on common principles for stability levies on banks, first, within Europe. That would also give us credibility to advocate for their adoption more broadly at the G20. We are also open to exploring the feasibility of adopting a global transaction tax in the financial sector.

Finally, and quite importantly, we should carefully assess the combined effects of these various regulatory changes, and the timing of their implementation, so as not to unduly stifle lending to the real economy and thus jeopardise the insipient recovery.

Indeed, the financial market reform agenda of the EU is very extensive. Keeping in mind that financial markets are presently global by nature, these reforms should be discussed and carried out, as much as possible, in the G20 framework, which I will touch upon next.

Climate Change

Ladies and Gentlemen**,**

Climate change and energy issues don’t belong directly to the mandate of Finance Ministers. However, new initiatives in these sectors have significant financial impacts on public finances. This is the main reason for the involvement of Finance Ministers in these areas.

The European Commission is presently analysing options for moving beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage, including consequences for each Member State. As you perhaps know, the EU is committed to taking a decision to move to a 30% reduction by 2020 compared to 1990 levels as its conditional offer with a view to a global and comprehensive agreement for the period beyond 2012. This is provided that other developed countries commit themselves to comparable emission reductions and that developing countries contribute adequately according to their responsibilities and respective capabilities.

As regards the fulfilment of the decisions of Copenhagen meeting last December, the EU and its Member States have advanced in the implementation of their fast start commitments for 2010. Finland’s share of the EU’s overall Fast Start Finance contribution is 110 million euros during 2010-12. We urge all other parties take care of their obligations agreed in Copenhagen, as well.

These climate targets are very challenging for Europe and especially for Finland where industrial structure is energy intensive. For example, we have engaged to increase the share of renewables to 38 per cent by 2020.

The Finnish energy policy has traditionally based on large variety of energy sources and technologies. To be able to attain the agreed climate target the Government has agreed on a wide energy package. Building more nuclear power and exploiting more effectively forests as a source of renewable energy create important parts of the package. Also, a lot of new wind power will be constructed, but its role remains relatively small when we look at the entity.

Towards Sustainable Development

Ladies and Gentlemen,

It is worrying that the positive development results we have seen in many parts of the world over the past years are in danger due to the triple crises: namely the financial, food and climate crises. These global challenges have made the agenda of sustainable development more important than ever.

Finland's development policy is based on a comprehensive view of sustainable development in its three dimensions: economic, social and ecological. The main goal of our development policy is to eradicate poverty and to promote sustainable development in accordance with the UN Millennium Development Goals set in 2000.

Finland and the EU remain determined and committed to support the achievement of the Millennium Development Goals by 2015. All parties need to agree on concrete actions aimed at increasing ownership by developing countries, improving the impact of policies, mobilising more and predictable financing for development as well as making more effective use of development resources.

I would like to emphasize the importance of a global partnership for development as called for in MDG number 8. A global partnership should be created involving the public and private sectors in both developing and developed countries.

In order to be effective in our joint development efforts and to reach fast and lasting results, we have to build on the principles of sustainable development. Eradicating poverty is possible only if progress made in developing countries is economically, socially and ecologically sustainable.

I am very glad to note that discussions on these issues will continue between our two countries as President Tarja Halonen of Finland and President Jacob Zuma of South Africa have been appointed as co-chairs of the UN High-level Panel on Global Sustainability. The recommendations of the Panel will be used, for example, in the preparations for the UN Conference on Sustainable Development in 2012 in Rio de Janeiro. This conference is a follow up on the 1992 Earth Summit in Rio and the World Summit on Sustainable Development held in Johannesburg in 2002.

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Ladies and Gentlemen**,**

In the last two years the global economy has experienced the largest turbulence since the 1930's. The economic recession has hit hardest on developed countries, including all European Union countries, while emerging countries have done distinctly better.

The European Union has responded to this challenge by reforming its structures and functions at national and Union level. This has not been an easy task, and the process is still going on. Once again it has been proved that large reforms can be carried out only through crises. Even though the economic recovery is still fragile I am confident that the EU, including my own country Finland, is now more ready to respond to the challenges ahead.

Thank you for your attention.