Keynote address from Mateusz Szczurek, Minister of Finance of Poland
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Investing for Europe's Future

Dear President, Jean Claude Trichet,
Dear Director, Guntram Wolff,
Dear Members of the European Parliament,
Ladies and Gentlemen, good evening,

Dear Jean Claude, dear Guntram, thank you very much for your kind invitation.

The Bruegel Institute is one of the most influential European think-tanks and the quality of its research is continuously increasing its impact on policy-making. It is therefore my honour and great privilege to be here and to address this exceptional audience.

Europe is at risk

We are meeting here at the time when Europe is facing a great threat. It is not the danger of sovereign debt crisis or of the collapse of the euro area. We have managed to decisively avert those risks through a coordinated effort at the European level. Unfortunately, neither is it the threat of the so-called "lost decade" because the "lost decade" is already Europe's baseline scenario. Remember, six years have already passed since the start of the financial crisis and European GDP is still well below its pre-crisis level and around 10% below the level consistent with trend growth prior to the crisis. As a continent we are doing worse than Japan in the aftermath of the financial meltdown of the 80s and worse than during Great Depression in the 30s. The timid recovery, which gave us so much hope, has recently stalled. Unemployment and the negative output gap are at record-highs and we are on the verge of deflation. Even Poland, with its continuing economic expansion, still faces elevated unemployment and below-potential growth.

You may ask: what risk could be added to such a gloomy baseline? It is the threat of secular stagnation, the trap of permanently depressed demand and meagre long term growth rates. It is also the threat of a lost generation: a generation of young people who will never find their way into quality employment and will never reach their full human and economic potential. To realize that such a gloomy scenario may already be unfolding, look no further than our labour market. Almost a quarter of all young people in Europe are without work. Persistent unemployment, inequality, and a debt burden increasing with each month of stagnant income and near-deflation threaten not only Europe's economic development, but risks unravelling the entire social structure of the European Union. The radical parties are gaining strength, and as Europeans we should never forget that it was depression and deflation, and not hyperinflation, that brought to power the totalitarian regime that devastated our continent through the world war and unspeakable atrocities 75 years ago.

Europe needs concerted and decisive action

Europe is not doomed, but we do need concerted and decisive actions at both national and European levels to close the output gap, create jobs and strengthen the long term growth potential, all the while ensuring the sustainability of public finance and the stability of financial sector.

Such actions, many of which we have already undertaken, span a wide spectrum of policies, reforms and regulatory changes. Much attention has already been devoted to three broad areas: structural reform, European monetary policy and national fiscal policies.

Structural reforms are essential to promote flexibility and increase long-term growth. We need labour market reforms, we have to cut red-tape and we must reduce the regulatory burden. Completing the Single Market is key to ensuring efficient allocation of resources; meanwhile, the European Banking Union should complement other reforms to promote financial stability. The crisis – despite its obvious costs– offers a tremendous opportunity to overhaul the ailing aspects of the European economy and to boost its potential.

The challenge looming on the horizon is deflation. This threat makes traditional monetary policy instruments inadequate or irrelevant. Reviving recovery and reaching inflation target therefore requires continued monetary expansion through unconventional measures. The recent announcement of President Draghi about possible QE operations in the near future is a source of optimism. However, this optimism should be qualified by the relative impotence of monetary policy at the zero bound: the situation when interest rates are already zero or very close to zero and cannot be reduced further.

The new European fiscal framework will be the foundation of public finance sustainability. Together with ECB's resolve, it has already restored confidence and averted a debt crisis. This is a great achievement. But to provide more growth momentum, we need smarter national fiscal consolidation strategies within the constraints of the Stability and Growth Pact (SGP). And I underline here the importance of the SGP rules as they represent necessary restraint and provide trust in our economic policy in Europe.

Europe needs investment

Ladies and gentlemen, while progress on each of these three fronts: structural reforms, monetary policy and public finance stability is necessary, it is time to face the fact that it will not be sufficient. It will not be sufficient to overcome the fundamental problem holding back the European economy: depressed investment demand.

The economic crisis caused a historically unprecedented collapse in capital investment in the European Union. Six years after the beginning of the financial crisis, private investments are still almost one fifth below pre-crisis levels. Public investment also fell significantly. This has become the main target for fiscal consolidation in most of Europe, with cuts reaching 60% in some countries.

Investment is very low when it is needed more than ever. Higher capital expenditures could be a powerful way to boost economic recovery and close the output gap in the short-term, as investment multipliers are particularly high in deep recessions. This is especially true during the balance sheet recessions when private sector is in the process of deleveraging, while interest rates are constrained by the zero lower bound, unable to balance saving and investment. Greater investment would also increase long-term productivity growth rates in Europe, further stimulating private capital expenditure. What is more, scaling-up of investments is also critical for achieving the vision of Europe 2020, the vision on which all Member States agreed and which we all share.

Those who fear that secular stagnation is already our reality point to a particularly worrying combination: an investment shortfall coincides with historically low interest rates. Cheap and plentiful savings are not being transformed into productive capital for three reasons. First, the private sector lacks confidence in future demand for its products; second, real interest rate cannot turn negative due to deflationary environment; and third, in most EU member states the public sector lacks fiscal space to scale up investment operations. Meanwhile, necessary structural reforms will take time to bear fruit, and often have only an indirect influence over the crucial saving-investment balance.

Time for action at the European level

I believe that to overcome these constraints, we need a decisive public investment initiative at the European level. I propose that we take advantage of the favourable financial market conditions right now in order to undertake strategic public investment projects across Europe and in line with the rules underpinning the Stability and Growth Pact. It will aid our growth in the long term, while at the same time helping us escape the current economic weakness and avert the danger of a generation-long stagnation.

We estimate, based on conservative assumptions about the size of the current output gap and fiscal multipliers, that closing the output gap in the medium term requires phased-in European public investment spending of around 5.5% of European Union GDP or 700 billion euros[1].

The capital spending would start at 0.5% of European GDP in 2015, peak at 2% in 2017, and be gradually phased out afterwards. This path is proposed as large scale public investment projects are likely to take time to get started. It also gives policymakers time to react and adjust the size of the initiative if economic conditions change in the coming years.

The proposed initiative should ensure that infrastructure critical to the long-term growth of Europe is put in place, in line with estimates given by the European Commission. The additional resources should supplement – not replace – European Investment Bank financing and the multiple functions of the EU budget.

How to mobilize such considerable investments? We propose to establish the European Fund for Investments, preferably operating as a special purpose vehicle under the umbrella of the European Investment Bank Group. The capital of the Fund would be leveraged by borrowing in the financial market and directly invested in the selected infrastructure projects because Europe needs actual capital expenditures, not merely extra funding. Even in Poland and Germany investment credit demand remains subdued.

Direct public sector participation would bring in private investors, who are currently chasing a relatively small number of potentially "bankable" projects, because they tend to consider large-scale infrastructure projects too risky in terms of future demand, regulatory environment and profitability. The assets created through these investments would eventually be privatised, generating revenues for the Fund. However, the logic of the excess savings at the zero lower bound, as well as the experience of other balance sheet recessions should make us prepared for prolonged ownership of newly created assets.

[1] See the analytical note.

The Fund's size, its direct investment in infrastructure and long-term investing horizon would be the key differences with the existing European Investment Fund, which has only 4,5 billion EUR capital and facilitates SME's access to finance through intermediary institutions with shorter investment horizon.

To start operating, the new vehicle would require a gradual injection of paid-in capital and guarantees by all EU Member States in a similar way and on the similar scale as was done for the European Stability Mechanism. This would be necessary to ensure its triple-A rating. The contributions of Member States to the capitalization of the Fund would be excluded from the calculation of the budget deficit and its borrowing on financial markets would be recorded as EFI debt, and not re-routed to the Member States. This treatment would be exactly the same, as it is the case under the ESM, and in line with the rules underpinning the Stability and Growth Pact. It is important that all EU Member States take part in the initiative to prevent free-riding.

The Fund would facilitate directing currently idle private savings towards large-scale, pan-European infrastructure projects, with particular focus on energy, transportation and ICT. These sectors have long been defined as priority areas for long-term sustainable growth in Europe, and the principle of subsidiarity justifies taking the action at the European level. These investment projects would contribute to energy interconnectedness, independence and security, also known as energy union, reduction of carbon emissions, promotion of trade, investment and mobility among Member States, and shifting Europe towards digital union and knowledge-based model of growth.

At the same time, investment projects in the most depressed economies, as measured by output gaps, should be prioritised through front-loading. The Fund must not become another income redistribution tool. It should not promote economic laggards whose inadequate growth is simply a result of their structural weakness. But it will be a mechanism for synchronizing the business cycle, it will combat intra-European imbalances and reduce the pressure on labour migrations and on macro-prudential regulation. Moreover, it will result in Member States competing in reforms to increase potential output.

Many of you will be asking yourselves if Europe can afford to take on such an additional financial burden at the current juncture. The question is whether we can afford not to take it on. Before you answer that question, consider the present market conditions. Consider the historically low interest rates. Consider the potentially large multipliers generated by investment spending in a depressed economy. Consider the stimulus to demand and the uptick in long-term growth rates. Consider the additional publicly owned capital stock. Consider the evidence that public investment may actually reduce debt in medium term and strengthen long-term sustainability. And consider the alternative: the risk of secular stagnation, which may already be with us. Do we really have a choice?

Ladies and Gentlemen, Europe's road to recovery requires us to show determination in reaching our goals and courage in taking difficult decisions. Steps undertaken to counteract the recent crisis prove that, despite our sometimes divergent views, Member States can find mutually beneficial solutions to our shared problems. The future of the European Union depends on our determination to implement an ambitious agenda of reforms and on our capacity to adjust to new challenges.

At this juncture, boosting European investments is, in my view, the most important, but perfectly achievable economic policy challenge. This evening I have outlined an effective and fiscally responsible economic and institutional answer to this challenge. I am looking forward to working with all our European friends to develop it in full detail, and to implement it as promptly as possible.

In conclusion, let me make one thing absolutely clear. I am happy and proud that Poland was the only country in Europe that never stopped growing throughout the crisis. However, we cannot afford to be complacent. As Europeans, we can sustainably meet our growth aspirations only within strong and growing Europe. The responsibility for ending the lost decade and avoiding the lost generation is on all the EU Member States, and the European Fund for Investments is the way to achieve this goal. This is why, I can confirm without any hesitation that I would like to see Poland as its founding member.

I am counting on your support and cooperation.

Thank you very much