SPEECH

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Financial Markets versus Political Power: the European Response

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Ladies and Gentlemen,

We definitely live in interesting times.

An IMF report a few weeks ago suggested that China would become the largest economy in the world within five years. The euro area is going through a deep economic crisis. During the summer break, the financial markets went into turmoil. For the first time ever a credit agency downgraded the US debt. The Dow fell 14.2% in August, one of the largest 10-day drops the 50's. European stocks lost about 20% of their value since the start of the year - not to mention the serious decline over the last few weeks. The economy is slowing down in the US and the EU, leading to negative forecasts.

Our citizens are concerned. They legitimately ask the question: What's going on with the markets? Who is managing this huge crisis? Are the politicians still in charge?

This is a vast subject. But I would like to focus on two main points. First, on the strained relationship between markets and political power. Second, on the response of the European Union and the need for European and global political solutions.

Over the last years, the equilibrium between markets and political power has been disrupted.

The financial markets discovered a lot of new ways to make profits. They drifted away from their traditional mission and disconnected themselves from the real economy. They invented innovative products and became exposed to high risk speculation. Some praised the financial innovations of the last years. Others remained sceptical. I quote Paul Volcker, the former chairman of the US Federal Reserve, who once remarked that the only truly useful financial innovation in the past 20 years is the cash machine!

Still, the question remains. Are the markets evil by nature? I don't think so. The markets don’t sit around figuring out how to rip us off. They are profit maximizers. In their quest to maximize profits, they have certain advantages, when compared to political power.

Markets are by nature impatient. They act quickly. They interpret slow reaction, political division and lack of courage of governments and economic actors in their own way. They are also very cynical. They act globally – and they have a massive impact. This contrasts sharply with the fragmented, complicated and often contradicting ways of the political power.

Now let's come to the **political power**.

The balance between the markets and the political power has been disturbed even more during the current economic crisis. The political class has a share of the blame to take. No one can deny this.

First of all, it failed to see the crisis coming. The political systems, on both sides of the Atlantic, failed to set up the appropriate warning mechanisms to predict the crisis. Over the years, they relaxed the financial sector supervision and trusted self-regulation in an unprecedented way. At the same time they let public and private debt accumulate too much, too fast.

Then the crisis came. It was time to react. But the reaction was slow. And it still remains slow.

Bill Rhodes, Chairman of Citigroup in his recent memoirs said: "When facing an economic crisis, the clock is always running against policymakers. Time is the enemy."

Quite justifiably so. As opposed to the markets, which can react in no time, the policy makers are by definition much slower. Political power needs democratic legitimacy, something that the financial markets can forego. The democratic process means that we should enable an open debate, aimed to reach a synthesis of different opinions and a socially acceptable outcome. It is a gradual process. But that is the way our democratic system works. I absolutely insist on this point: we need this system. We have, of course, to work on how to simplify and improve it. But, sacrificing our democratic values, not only for ideological, but even for social and economic reasons, is totally out of question.

We live in a globalised world. The current international context is complicated. The national economies across the world are interconnected. Still, they operate in very different ways. The principles applied are not the same everywhere. The risk of contagion remains too high. Throughout the world, regulatory approaches are different. The supervision of the international financial markets is fragmented. The lack of solid governance structures at global level is all too evident.

There is also a competitiveness issue. There is a growing gap among nations. There are countries which have sustained high rates of growth. And there are others whose economies are trapped in a stagnation and recession spiral.

The economy needs both the markets and the politicians to operate in what I would call an equilibrium. The political power should supervise the markets appropriately. The markets should benefit from the merits of forward-looking regulatory oversight.

The political power should try to reconcile the needs of the markets with the needs of the majority of the citizens and the needs of the real economy. We have to heal our wounds and we need simplicity, efficiency, credibility and accountability.

However, this was not the case. The political reaction, during this crisis management period, was not up to the challenge. It was inadequate and it suffered from short-termism. It was a relief. But it was definitely not the solution.

There was a bubble in the global economy. Next time around we should be better equipped to address it. This would mean, among other things, that the role of the credit agencies should be re-evaluated.

Now, let me turn to the **challenges ahead for the European Union and beyond**.

In Europe the economic outlook is rather dim. The European Union, even before the crisis broke out, was already facing structural problems. The productivity gap between the EU and other economies had widened over the previous decade. In 2009, the GDP had fallen by 4%. The industrial production had dropped back to the levels of the 90's. The rate of unemployment was too high. 23 million people, or 10% of its active population, were unemployed. The average growth rate was lower than that of its main economic partners. To make matters worse, Europe is facing a serious demographic challenge. Its population is ageing – and this puts additional strains on social expenditures.

The main problem is the following: **since the start of the euro, the macro-economic imbalances among Member States of the Euro Area have not been successfully addressed.** Since the introduction of the euro, the competitiveness gap between Germany and the less competitive countries has doubled and is getting bigger and bigger. A number of Member States had been transformed into importers and consumers of goods and services. Encouraged by the favourable financing rates of the Euro zone, they chose to borrow money and spend, spend, spend.

Greece is the emblematic case here. It was about easy spending, well above its means and its productive capacity. We, the Greek politicians across political parties, share a heavy responsibility. Greece has to do a lot and solid results are desperately needed. It is not only the Euro-crisis that has severely impacted on Greece. It is mainly its own serious deficiencies, which have led to this unsustainable economic situation.

But it is not only about Greece.

The design of the euro had a structural problem. We established a common currency without having established a common, not even a harmonized, economic policy. So the euro performed during the "sunny days" of economic growth. But it was not well equipped to deal with a severe crisis. It lacked the supporting structures and attributes of any other currency in the world: the power to raise taxes, to issue bonds, to make decisions.

This became obvious when the financial crisis hit extremely hard the most heavily indebted Member States.

Due to the strong interdependence among the economies of the Euro area, three rather small Member States, representing 6% of its GDP, put in danger the financial stability of the entire euro area. The markets speculated heavily on this.

Did the European political system give the proper answers? I have to admit that, especially in the beginning, we were largely not up to the challenge.

Let me be a bit more specific. When the financial crisis broke out, the national governments decided to bail out their banks. Unfortunately, they missed a great opportunity to carry forward a sweeping reform of their financial sectors. None of the all too powerful banks was broken up. Most of the high risk financial products are still on the market. The governments saved banks which were, not only too big to fail – but mainly too big to bail. The taxpayer paid for the bail outs. The moral hazard was substantial. The banks were saved and now it is more or less business as usual.

When the crisis broke out, the EU had to react since too much was at risk. But there was no toolbox. There was no mechanism in place for this type of rescue operations. **The EU had to fill the gaps in no time.**

The European Commission had to step in. We proposed to bail out the three Member States. We took the initiative to address the structural shortcomings of the financial markets. An overhaul of the financial sector was proposed. Its aim was to reinforce regulation and supervision and to safeguard against systemic risks and excessive risk-taking. We proposed a new framework for Credit Rating Agencies, including the introduction of a European independent credit agency. We also addressed problems concerning Derivatives and Short Selling and designed a new architecture for a European-wide financial supervision. This effort is on-going. This legislative package has to be adopted by the two co-legislators in the European system, the Council of Ministers and the European Parliament.

But is this enough? Obviously not.

The crisis is still here – and even somehow deepening. It hits the headlines in the international media almost everyday. The markets are jittery and volatile. And they are hitting hard, based on real or perceived weaknesses.

The European Commission tried hard to build our response around one key word: **solidarity**. This was the driving force behind the new innovative mechanisms, like the EFSF (European Financial Stability Facility) or ESM (European Stability Mechanism). Today, this spirit of solidarity is under heavy pressure.

We reached a critical point of the European integration process. A legitimate question would be to ask if the European project has run out of steam.

Over the last fifty years, the economic integration of the EU has been successful. Still, the economic crisis has made us realise the hard way that perhaps the current European architecture has reached its limits.

So, how are we going to move forward?

Europe is faced with three choices. One way to address this crisis would be to continue muddling through. This would mean that we don't exactly know where we want to go, and that we react in a hesitant way. That we opt for the short term. And that we hope that in a magical way, the economy will bounce back.

The other way ahead would be disintegration. There are some national politicians in Europe who are pointing to an exit strategy of Member States from the Euro area.

The third way would be to move to the next level of European integration. The ambition is to address the political and institutional deficits and to reinforce the economic position of Europe in the global economy. I support the third way. **We need more – not less Europe.**

Why is that?

First, because this is the only chance for Europe to survive in the context of this global economic transformation which is underway. Size matters. **Europe counts because as a whole it has the adequate size.** The EU has 7% of the world population and 20% of the global economy. It is the most important trading partner in the world. This is why we count. The European countries, even the more competitive ones, cannot survive on their own. The politicians, supporting the neo-populist and neo-nationalist ideas, are missing this point.

Second, because **Europe has already taken a lot of major steps towards integration**. The European currency has been the fundamental one – but not the only one. Despite the problems, the process of political coordination is already in motion.

But now we are very reluctant to go the extra mile. Why? Let us face the truth here.

Under today's system, further integration steps will be very difficult. We are approaching fast those policy areas which touch upon the **core of national sovereignty**. This will require a major rethink of our political and institutional set-up.

Above all, it is a question of **leadership**. Europe's political class needs to make brave decisions. This will mean that the politicians will need to avoid responding only to national short-term interests.

I have been in politics for almost all my adult life. I am fully aware of the difficulties and the constraints involved. But crisis time is leadership time. It is time for Europe's leaders to leave the sidelines. I am convinced that "more Europe" is the way to go. The EU can tackle the Euro area debt crisis and the other challenges ahead only if it moves in the direction of more integration. This means that this is the moment for a political and fiscal union. This is not about idealistic federalism. It is about offering the right and most powerful solution to a persisting systemic crisis. **This means that we have to accept transfers of national sovereignty.** There will be resistance. But I hope that the political class in Europe will find the strength and courage to move forward.

Ladies and gentlemen,

In the inter-connected world we live in, there is a **need for global solutions**.

If we do not cure the deficiencies of the current international financial system, the mistakes of the past will come back to haunt us. Our global economic governance needs to be reinforced. The G20 process aims to fulfil this role. However, much remains to be done. The EU and US should work together on this issue. The emerging economies should join a global supervisory system, something that is in their own long-term interest.

The EU and the US must work jointly and decisively through these turbulent times. The prospect of a global crisis cannot be excluded. The economic crisis is also putting in danger the foundations of our democratic societies. It is a source of discomfort. It is not only threatening our economy, but it is undermining the societal structure and, ultimately, it runs against our democratic ideals.

Apart from being the largest economies of the world, **the EU and the US are also the leading democracies.** They strongly defend the democratic values world-wide. We are here to spread those values and to enhance a global democratic governance process. Since the markets and international capital are moving very fast towards global integration, we need a global democratic response – now. This will also be in the interest of the emerging economies and other countries with fragile societies.

I hope that the political class in both the European Union and the United States of America will see the real issues. This is not about the economy only – this is about our global political system and future.

Thank you.