

**Speech by Marco Buti**  
**European-American Business**  
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**Post-crisis EU and G20 governance**

Ladies and Gentlemen,

Thank you for your kind invitation. It is a pleasure to be here today. The topic I will focus on is the current economic challenges we face and how we address them on an EU and a G20 level. I will outline this process along the lines of global policy challenges and solutions.

Let me start with the **challenges**. The crisis has revealed three main sources of weaknesses:

- The financial sector
- Public finances and sovereign debt markets
- Economic growth

The first weakness is **vulnerabilities in the financial sector**. Banks were severely hit and the public sector had to intervene to prevent the worst. Even after public interventions however, banks have been significantly weakened in their capacity to provide financing to businesses and households.

The second weakness is **public finances**, which has found specific expression in the **sovereign debt crisis**. The crisis took a heavy toll on public finances via two channels: the fall in economic activity and the need to support the banking sector. In Greece, for example, the fall in GDP during the crisis exacerbated the existing weak fiscal position and raised doubts among investors about the abilities to service debt. In Ireland, on the other hand, the relatively sound fiscal position before the crisis was damaged by the support the public sector extended to the banking sector. As a

result, investors' confidence waned resulting in serious turbulence on the sovereign market.

The third weakness is **growth**. The crisis has been the most severe economic crisis since World War II. World GDP saw the first outright fall on record. Although recent data confirms a positive momentum of the recovery in the EU, developments remain uneven across Members States. This means that significant challenges for the EU - as in the US - continue to exist. Due to the depth of the financial crisis and the way it has affected the credit transmission mechanisms, EU and US GDP growth may remain subdued for some time. Continued high unemployment in the US and in some parts of Europe might be a consequence. In addition, Europe and the US have inherited large government deficits and rising debt-to-GDP ratios. The service of public debt adds to the costs related to ageing populations. Coping with these combined challenges requires more flexible economies capable of competing in a globalised world.

To find **solutions** for these challenges, decisive steps have been taken on the EU and the global level:

First, with regard to **the financial sector**, the EU has agreed on a new architecture for financial regulation based on four priorities:

- The development of a more efficient supervisory response
- More and better capital in the banking system
- The extension of the perimeter of regulation and supervision
- The completion of the tools to ensure financial stability.

Second, to **safeguard the stability of sovereign debt markets**, the EU has created two new lending facilities for eurozone countries in distress: the European Financial Stability Mechanism or EFSM and the European Financial Stability or EFSF. The EFSM has a volume 60 billion euros. It is administered by the European Commission and is similar to the facility that had previously been set to help the non-euro area countries Latvia, Hungary and Romania. The EFSF is a special purpose vehicle set

up to make loans to euro area countries up to an amount of 440 billion euros, supplemented with a 250 billion euro IMF commitment. These are crucial safety nets and provide sufficient funding in case of need. The mechanisms are fully operational and have the ability to support vulnerable countries, as the recent example of Ireland shows. There's not free lunch, obviously, and any financial support is provided under strict conditionality.

These mechanisms are of temporary nature and will be replaced by a permanent crisis resolution mechanism after 2013. Discussion on the design of the permanent mechanisms is currently ongoing. However, to avoid any misunderstanding let me underline that the current sovereign debt problems will be handled according to the current and firmly agreed policy, which excludes sovereign debt restructuring.

To secure the stability of public finances, the Commission has recently also proposed a significant strengthening of the EU fiscal surveillance. It is also important to point to the significant efforts by EU member states to address challenges in the budgetary, competitiveness and financial sector area.

Third, on reinvigorating growth: Decisive regional and global policy measures to support growth in the EU and the US, as well as by their G-20 partners, are behind the recovery from the worst recession since the Great Depression of the 1930s. As a result, the world economy recovered strongly in the first half of this year. We will continue to work together bilaterally and multilaterally to ensure that this rests upon solid and sustainable foundations.

**At the EU regional level,** we have launched the so-called "**Europe 2020 Strategy**" for smart, sustainable and inclusive growth and jobs. The Europe 2020 Strategy was agreed this summer and brings together reform efforts in various areas such as labour and product markets, and innovation and education, while at the same time paying attention to climate change and social inclusion. To jump-start the Strategy, Member States have committed to "frontload" the implementation of key reforms that can have a positive impact on growth already in the short and medium term.

An important part of the Strategy includes the monitoring of **macro-economic imbalances** such as large current account deficits or bubbles in housing markets. The crisis has also shown that these can be very harmful for growth and stability.

This is why the Commission has proposed a framework to monitor imbalances, including an alert mechanism comprising a scoreboard of indicators and thresholds and the possibility to issue policy recommendations and sanctions. In fact, a similar mechanism is now also developed for the global – G20 – level.

In addition, the EU have instituted a "so-called" **European Semester**, comprising the first half of each calendar year. The European Semester has two major aims:

- integrated macro-structural surveillance of fiscal policies, key structural reforms that address growth bottlenecks and macro-imbalances, and financial systems.
- And ex-ante policy advice: Commission and Council prepare guidance, opinions and recommendations at a time when important budgetary decisions are still in a preparatory phase at the national level.

**On the global level**, the downward spiral of the global economy during the crisis was stopped thanks to close cooperation and multilateral policy response of G20 members. Now, **the major downside risk for the global recovery** is probably due to the limited progress made so far in the **rebalancing of global growth**. This has led to a rise in international economic tensions, in particular with regard to exchange rates and capital flows. We must avoid that these tensions get out of control and derail the positive results obtained so far.

To ensure that the discussion, and, where needed, remedial policy actions on the imbalances are based on sound economic rationale, G20 Leaders agreed in Seoul to **set up a mechanism to assess the root causes of macro-imbalances** and to identify the impediments to adjustment by the next summit in November 2011. I would not go as far as Larry Summers<sup>1</sup> when he says "that we have the most serious framework in place for addressing global imbalances that a group of countries has

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<sup>1</sup> The Wall Street Journal, November 22, 2010, p. R10.

ever put in place..." After all, we still have to finalize it, but it is true that the mechanism is an important step forward in international economic cooperation.

This new **mechanism has significant similarities with the proposed EU alert mechanism** that aims at preventing the development of unsustainable internal economic imbalances. While our EU scoreboard has been designed to address EU internal imbalances and therefore may not fully fit the mechanism we are setting up, it may help to define the scope of the indicative guidelines and find a consensual method to address global imbalances. With such a method, we would not rush into hasty policy conclusions. Still, we should be able to take action if we conclude that the imbalances depend on the policies that a country is implementing.

With regard to exchange rates, in Seoul, G20 Leaders have given a clear signal for a cooperative solution to the current currency tensions, recognizing that without it there will be no success in rebalancing growth. The commitment by G20 Leaders' to move towards more market-determined exchange rate systems and to refrain from competitive devaluations is hence a very positive step forward. The Seoul communiqué addresses widespread concerns about competitive devaluations, but also other actions that may have beggar-thy-neighbour effects. A major challenge is now to put this resolution into practice.

While rebalancing growth and addressing exchange rate issues have recently been at the centre of attention, let me also point out that in Seoul we have also made **important progress in international economic cooperation** by agreeing to promote structural reform, conclude the reform of the IMF, implement financial regulatory reform, provide new momentum to the Doha Round, make progress on development issues and global governance reform at the G20. While we are aware of the need to progress further on some of these issues, on many we have already made significant advances, ensuring that the post-crisis international economic system will be based on strong and sound economic foundations.

## **Conclusion**

Kissinger<sup>2</sup> once said - even if in a completely different, non-economic context - "We now know that we face the imperative of building a new world order or potential global catastrophe. It cannot be done alone by either side of the Atlantic." Indeed, we need a new world order in the economic sphere, and through the G20 we are building it. But we'll not make much progress without strong cooperation between the EU and the US. One of the biggest challenges will be not to lose momentum, now that the worst of the crisis is over. I'm confident that this will be the case, since both the US and the EU are well aware of their global responsibilities and, because of this awareness, they will continue to play an important leadership role. It is true that the international cooperation setting has become more difficult and impervious, but it is also more representative and legitimate. We should not be nostalgic of the old order, where advanced countries alone decided almost everything and emerging economies and developing countries had to follow, and still recognize that our joint endeavor is key to ensure that progress is made at global level. Thank you.

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<sup>2</sup> Washington Post, September 13, 2006