EUROPEAN COUNCIL
THE PRESIDENT

Brussels, 25 May 2010
PCE 104/10

Opening address by Herman Van Rompuy, President of the European Council, to the Brussels Economic Forum 2010 "Lessons from a crisis" Brussels, 25 May 2010

In September 1929, a New York investment firm placed an advertisement to attract savings. It briefly told the history of the Mississippi Bubble -- wild speculation in the early 18th century -- and then said:

"Today, it is inexcusable to buy a 'bubble' -- inexcusable because unnecessary. For today every investor has at his disposal facilities for obtaining the facts." These facts would substitute the "sound principles of investment" for the "hazards of speculation", so said the ad.

The men and women who believed this and rushed in to invest their savings -- they were disappointed quickly, just one month later, by the great October 1929 stock market crash.

It is a pleasure and an honour to give the opening address of this 2010 edition of the Brussels Economic Forum. Judging by the program, it looks like you are going to have a very stimulating day and a half.

Some of you may recognise the advertisement I just referred to. One finds it in the recent book by Carmen Reinhart and Kenneth Rogoff, This Time Is Different: Eight Centuries of Financial Folly (2009). The book is widely acclaimed and rightly so. The title is ironic, of course. The author's central claim is that the risk of financial crises has been systematically underestimated throughout history, until today. Every generation of economists and policy makers believes it has ended the cycle of boom and bust. The reasons and words may vary, from "today we have the facts" (in 1929), to "now we have securitized debt" (in 2007). But the refrain is the same: "This time is different".

Every generations believes that.

And, well…, more than one generation has been disappointed in this belief. The book surely makes for sobering reading.

Why do I mention it? Because it helps us to put things into perspective. In the light of this long history of financial follies, one can "de-dramatise" today's discussion on the public debt crisis.

P R E S S

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Accidentally, the recent events have put into question the very title of this conference: "strategies for a post-crisis world"… That looks a bit optimistic today. Are we already after the crisis? Maybe not. Or not yet. I prefer to speak about the ‘post-recession’.

By all means, the timing of today's and tomorrow's Forum is apt: after a tense period, culminating in the weekend of 7 to 9 May, the European Union has itself bought time.

Time for reflection and time for action. Let us use it well -- politicians, economists -- all of us.

Before we are ‘post-crisis”, we need to get there. Therefore I should like today to share some thoughts on the current crisis of public debt. I will do so in three points.

Firstly: how did the European Union deal with this crisis?

Second issue: what lessons should we draw from this crisis, in terms of economic policy?

Third issue: what lessons should we draw, in general political terms? What does it mean for the state of European integration?

A final preliminary remark. We are gathered here at an economic forum. So I could talk balance of payments, and balance of trade, and structural growth.

However, in front of such a distinguished audience of experts, this could be inappropriate.

As the saying goes: "You don't serve pasta to the Italians"…!

I do abstain from serving "pasta" with a little regret, though. As you may know, I am an economist by training; my first jobs were at the Belgian Central Bank and teaching economics at the university. Then, however, I went into politics. To continue the cooking metaphor, I left the pasta for "sausage making"... (For those of you unfamiliar with the image, it was Bismarck who once said: "Laws are like sausages, it is better not to see them made.")

Let’s get to the first issue: how did the European Union deal with the crisis?

I should like to focus on the facts, not to the perception.

In my judgment the EU did reasonably well. We stumbled, but we did not fall.

The EU works under a lot of political constraints. These are often underestimated by outside observers. In any political system, there is a difference between coming up with a plan, and getting it adopted by a parliament and accepted by the public. (Just think of the American health care plan!) In the European Union, the difficulty is even bigger. We are not a single state. In the case of the Euro zone, we are dealing with 16 governments and 16 parliaments, with very different public opinions.

Moreover, at the start of the Greek crisis, we did not have the instruments. The Treaties don’t provide instruments to deal with a debt crisis. The founders of the Economic and Monetary Union were convinced that the Stability and Growth Pact would suffice to keep budget deficits low. The implementation was deficient. Member States gave the wrong signal in 2005 when they softened the Pact. Economic growth and the absence of significant ‘spreads’ worked as a drug. Notwithstanding the absence of instruments, we were able to develop them. We built a lifeboat at sea. Anybody who ever tried, knows this is not easy!

From the start, the European Council had a double guideline: responsibility and solidarity. These were the two guiding principles to which all Heads of State and Government of the Euro zone subscribed. Responsibility, by the Greek government. Solidarity, by the others, in order to protect Greece (and indirectly themselves).

I also stress that, during the process, we kept all our commitments towards Greece. Let me recall the facts:

- In February, we agreed on the principle to take action to safeguard the euro's stability and to help Greece.
- In March, we agreed on the mechanism.
- It was only in April, on the 23rd, that Greece for the first time asked for support.
- A week later, on 2 May, a deal was reached, and one week later, on 7 May, the support mechanism was effectively triggered.

All along, the European Union did what it promised, and when it was needed.

Now, in the final stage, between 2 and 7 May, we were no longer just talking about Greece, but about the risk of contagion to other countries. It was a very serious threat to the stability of the euro and the financial system. That's why we decided, in a special meeting of the Heads of State and Government from the Euro zone on 7 May, to use "the full range of means available" to protect the euro. These were no empty words. During the following 48 hours, all institutions and Member States assumed their responsibility:

- The Commission rapidly made a proposal;
- The finance ministers agreed on an impressive safety mechanism for the Euro zone -- the 750 billion euro package --, before the opening of the Asian markets;
- The Central Bank, independently, changed its policy with regard to sovereign bonds;
- Two Member States immediately announced extra cuts to reduce their deficits.

One should consider these actions as one, common European effort. Taken as a whole, they clearly show the Union is able to act. To act decisively.

I think this was widely recognised. Still, one hears critical assessments. For instance, the EU was only able to act when confronted with imminent collapse. Or, the EU only bought time.

Listening to some commentators, one gets the impression we are living the biggest crisis since the Second World War, or even the First one. Last week, one observer urged European leaders to use the Churchillian language of "blood, toil, tears and sweat" in order to convey a sense of urgency. Well, it is not exactly the outbreak of the Second World War... We are not in the monetary Armageddon. Verbal inflation will not bring back confidence. It is a political duty to keep a sense of proportion. We are certainly in a critical moment; one can call it "unprecedented" and "historical". But crises are always unprecedented, that is the whole point. Therefore I am glad that the EU has been able to deal with this one. It took time, the coordination was difficult, but it is the result that counts.

Another line of critique dismisses the safety mechanism for the euro as “only buying time”. This disdain is odd. In economic thinking, time is a cost. But not so in politics! In politics, like in human life in general, time is the most precious good. Politicians try to shape it, in order to get things done. Every radical change, such as Greece is now embarking upon, requires time and respite; a temporary protection from the pressure of events, in order to better face them afterwards. The Union has now created this breathing space, which did not exist before. The safety mechanism gives the Greeks time to put the house in order. Therefore the loans are conditional. Conditionality is key in this matter. I am confident they will surmount this crisis.

Not only the Greeks must use this time. So should the Union as a whole. As President of the European Council, I urge all actors to focus now on the steps ahead. I just said that during the crisis, we stumbled, but did not fall. In the situation, that was not bad. However, we have now reached the point where stumbling itself could be dangerous. I think we are all aware of that. Therefore we need prudence as much as ‘courage’. The next steps will determine the fate of our Economic and Monetary Union.

This brings me to the second issue of my talk: What lessons should we draw from this crisis, in terms of economic policy?

Quite clearly, the key priorities are fiscal sustainability, avoiding that public debt spins out of control, and being able to deal more effectively with financial trouble.

Simply put, our two main missions are improving crisis prevention and crisis management.

In fact, these are the two subjects of the Task Force on Economic Governance which the European Council has asked me to chair. I should like to take this opportunity to briefly comment upon it. This will give you the state of play on the issue.

The Task Force consists of representatives of all 27 Member States - mostly Ministers of Finance -, plus Commissioner Rehn from the Commission, President Trichet from the Central Bank and Prime-minister Juncker from the Eurogroup, and myself as chairman. All key actors are around the table.

Last Friday we had our first meeting. I could feel a sense of urgency and a spirit of cooperation. Everyone shared the will to go forward together. I was impressed how quickly the state of thinking has evolved on the issue of public debt in a few weeks, not just in Brussels but also in the capitals. We hope to conclude a comprehensive agreement in October. In view of our fundamental and far-reaching purpose, that shows a certain ambition.

We already found agreement on the four main objectives.

Firstly, we should reach greater budgetary discipline. All agreed on the need to strengthen the Stability and Growth Pact. A lot of proposals are on the table. They concern both the preventive and the corrective side of the Pact. I will not go into the details here, but they include stronger warning procedures and new types of sanctions.

In the context of a stronger Stability Pact, one aspect may be of particular interest to you, as economists. So far, the focus has been almost exclusively on the maximum public annual deficit, the famous 3 percent of GDP. Much less attention has been paid to the level of public debt (the famous 60 percent). Public debt in the Euro zone is now 85 pct on average. It is as if we were looking at Member States’ fiscal positions through the keyhole of the annual deficit, forgetting the bay window of public debt. This needs to be corrected.

I add another remark. The Keynesian approach during the recession of 2008-2009 became in countries all over the world an excuse not to attach sufficient attention to sustainable public finances. As Belgian prime minister, I was rather cautious. In 2010, Belgium will have the lowest budget deficit in Western Europe.

The second objective is a reduction of the divergences in competitiveness between the Member States. This is vital, especially for the euro area. The Stability Pact remains the corner stone of European economic policy coordination. However, sound budgetary policies are necessary but not sufficient to ensure competitiveness. We could have known this from the start, but it took this crisis to hammer down the point.

Over the years, competitiveness in some Member States has improved thanks to wage moderation and productivity improvement. Others have accumulated important losses of competitiveness and balance of payments deficits on the current account. If one had taken a close look at the figures of these current accounts, the problems of some countries could have been predicted. But this was not a 'Maastricht' criterium.

These imbalances are a particular problem for members of the Euro area. Their loss of competitiveness can easily be covered -- until it is too late. Countries can no longer devalue, but keep advantage of low interest rates. In this respect, membership of the Euro zone acted as a "sleeping pill" for some economies. Nobody wants a "rude awakening" by the market forces. One idea therefore is to develop indicators of competitiveness. They should function as an early warning, a wake-up call. Some have proposed to go further, with corrective measures for those who do not act when the red light flashes.

Now, going from crisis prevention to crisis management, I come to the third and fourth objectives on which our Task Force broadly agrees.

Third objective: We need to have an effective crisis mechanism in order to be able to deal with problems such as those of today in the Eurozone. The general crisis mechanism that was put into place two weeks ago (i.e. the 750 billion euro package), will function for three years. The question is whether, and if so under which conditions, it should be developed into a permanent fixture of the system.

Fourth objective: We need to strengthen the institutional cooperation and coordination, in order to be able to act quicker and more efficiently when problems arise. In the Greek crisis, we did build a lifeboat at sea, but we can clearly not go on improvising like this. Therefore I intend to put proposals on the table of the Task Force for better coordination between the main actors.

These are our four central priorities.

A concluding remark on these economic policy lessons. A quick-witted mind might wonder, if you have perfect crisis prevention, why would you need better crisis management? Would it not be smarter to put all the cards on prevention? I do not think so. Again, crises are essentially unpredictable. Surely in the world of credit and financing, where credibility and confidence play key roles. Confidence is about emotions and psychology, just as much as about market value and economics. This should imply some modesty. To quote Rogoff and Reinhardt once more: "Economists do not have a terribly good idea of what kind of events shift confidence and how to concretely assess the confidence vulnerability."

In short: if we are serious about a European economic policy, we should do whatever we can to avoid the type of crisis we already know. That is what we did during the credit crisis of 2008-2009, when we avoided all the mistakes that were made in the 1930's because we knew them (for instance: this time, unlike then, we stayed away from protectionism, by safeguarding the European internal market). But we should also be able to deal with unforeseen circumstances. Not if, but when they arrive.

I now come to the third and final issue I should like to address. What lessons can we draw from the crisis in political terms? What does it mean for the state of European integration?

It is a huge subject of course, so just some quick remarks.

In a way, the old cliché holds: every crisis is an opportunity. It creates a possibility to act. To do things we were unable to do. Today, one can already feel acceleration in the pace of events.

But here again, a sense of proportion is in order. I do not belong to those who are cheering with a European flag and who are almost thanking the markets for obliging the European Union to take a step forward on political integration. European integration is not a goal in itself. I would rather not have had this crisis, and I am sure the Greek people and most taxpayers in the Union would agree.

However, now that we are at this juncture, as a Union, it would be irresponsible not to draw the right lessons. That is what the work of the Task Force is about.

Beyond the specific rules, however, we are clearly confronted with a tension within the system, the ill-famous dilemma of being a monetary union and not a full-fledged economic and political union.

This tension has been there since the single currency was created.

It was known to the diplomats and to the experts; it proved ammunition to euro's critics.

However, the general public was not really made aware of it (at least not by those responsible). The dilemma remained invisible. Nobody ever told the proverbial man in the street that sharing a single currency was not just about making peoples' lives easier when doing business or travelling abroad, but also about being directly affected by economic developments in the neighbouring countries. That being in the "Euro zone" means, monetarily speaking, being part of one "Euro land".

Today, people are discovering what a "common destiny" in monetary matters means. They are discovering that the euro affects their pensions, savings, and jobs, their very daily life. It hurts.

In my view, this growing public awareness is a major political development. It forces the governments to act.

What will they do?

We will take those steps towards stronger economic coordination, as currently under discussion in the Task Force. It is necessary and it will be done.

Moving forward will be delicate, because beyond the economics, fundamental political issues are at stake. Take the discussion on public deficits: all Member States want the others to play by the rules, they ask for sanctions, but at the same time they are not per se willing to have "Brussels" look anytime into their books...

I expect the steps forward to allow us to better deal with the fundamental dilemma, but not to eliminate it. Getting rid of it would require some federal jump, in which the centre would take precedence over the parts; that is not going to happen. Instead, Europe will stay in the realm of squaring the circle, between the Union and the Member States – but no doubt at a higher level!

In this respect, the European Council has an important role to play. Alongside the Commission and the Central Bank, it is responsible for the Union's economic governance. As the body where the Heads of State and Government of the Member-States gather to deal with common European issues, it is particularly capable of squaring this circle. It can assume responsibility for European decisions in front of national parliaments and public opinions, not at a technical level, but at a political one.

In the first proposals on the table of the Task Force, one sees other attempts to square the circle. Take the German idea to integrate the European deficit and debt rules into national legislation: it is a way of making visible that European rules are not just "from Brussels" – and therefore easy scapegoats –, but that they are self-imposed by each Member-State to the benefit of all. The same is true of the suggestion to hold national finance ministers accountable in their own national parliaments for the examination of the stability programs of their Euro zone partners. This may have disadvantages, but it would make visible that within the Euro zone, economic and fiscal policies of the partners are not just a matter of foreign affairs and old style financial diplomacy, but that they are, in a way, domestic affairs. These are encouraging shifts.

Let me conclude with the most important point. It brings us beyond the crisis, back to the main issue of your Forum. The point is quite simply this: we cannot solve our budgetary problems without more structural economic growth. Without growth, we risk a negative spiral. In the short term, the acceleration of fiscal consolidation will hamper growth in the Euro zone as a whole only marginally. I am even convinced that lower deficits will enhance consumer confidence and stimulate economic growth.

Moreover, the EU 2020 strategy remains absolutely important. The fiscal strategy has to prioritise R&D, innovation and education. They are key for the future, for increasing competitiveness. Therefore political leaders will be confronted with a reform programme in the budgetary field as in the socio-economic domains. All this will not be easy to achieve, but it is vital. The European Union and all Member States still have a long way ahead, but I am confident that all have the political will to do what needs to be done.