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the FORUM

NEWS FROM THE BRUSSELS ECONOMIC FORUM

Ageing: the clock is ticking… PAGE 2

Better regulation, not more is what de Larosière wants. PAGE 3

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Delivering on G20 commitments

Despite the pre-summit posturing in London last April, there was strong unity reached during the summit itself, and the G20 reached agreement on an important set of actions. A little over one month after the London Summit, however, where do we stand? Which measures have already been implemented and which remain to be tackled?

Concrete results

The G20 have forged ahead with implementation of their commitments. The first tranche of the $500 billion increase of the resources of the International Monetary Fund has been released to allow it to meet the rapid increase in the demand for IMF financing. Alongside this capital injection, tax havens, hedge funds and credit rating agencies will now be subject to stricter regulation, and work on capital requirements, executive pay and global accounting standards will be taken forward still in 2009. On a macroprudential level, the Financial Stability Forum has been replaced by a Financial Stability Board (FSB) which includes the European Commission, Spain and all G20 members. The FSB has a broader mandate to provide early warning of macroeconomic and financial risks and to oversee the actions needed to address them.

Europe makes its mark

According to European Commission President Barroso, “The European mark is clear in the [G20] conclusions … a united EU is driving this process.” Indeed, many of the EU’s proposals were accepted by the G20, and Europe remains particularly proactive in addressing the financial crisis. On 29 April the EU proposed a new package of initiatives on executive pay, hedge fund supervision and private equity, and before the end of May, the Commission will present a European financial supervision package. The package will propose a new architecture for European financial supervision including the establishment of a European body to oversee the stability of the financial system as a whole.

Shaping the new world economic order

Commissioner Joaquín Almunia shared his views on the lessons to be learned from the crisis, the long-term challenges we face, the G20 and Europe’s role in shaping the new world economic order.

How do you see the global economy and financial markets in the aftermath of the crisis?

I see more regulated, better supervised markets. But I also see a danger that economic growth within the EU will be even lower in the future. This is because financial markets, and the property sector, will be more cautious for a while and contribute less than they did before to economic growth. This is without even taking into account the impact of an ageing population, which will further reduce growth potential. We urgently need to increase productivity and develop new sources of growth, for example, in a green energy and low-carbon economy.

Regarding the global economy, I believe that the IMF, as the only truly global economic organisation, should be given the authority not only to issue warnings about the building up of global imbalances, but also to promote their orderly and timely unwinding. Global imbalances are at least partly to blame for the current crisis. We knew that some countries were living beyond their means whereas others were relying excessively on external demand and building huge current account surpluses. In 2007, the IMF tried to promote an orderly correction of these imbalances by bringing the main countries involved around the table. But nothing happened, despite the clear recommendations given to each of the participants.

We need to draw lessons from the past and from the crisis and, for this, it is absolutely essential that central banks and governments begin withdrawing the huge monetary and fiscal stimuli that have been put in place since about a year ago, as soon as the economy starts recovering. Otherwise, we risk a resurgence of inflation and other asset bubbles.

You mention ageing, isn’t it odd to address a problem that is only going to materialise in 40–60 years when we are still struggling with the worst crisis since World War II?

On the contrary – policies to counter the impact of ageing populations on our economies have never been more necessary. Ageing populations imply serious challenges for Europe’s economies and social models. Many Member States will already begin to feel the effects of ageing in the coming decade. But the labour supply will continue to increase for the next few years and this gives us a small window of opportunity to implement the structural reforms that ageing requires.

The increase in unemployment and deterioration in public finances that we are seeing as a result of the crisis mean that a redoubled effort to implement our ageing strategy is needed. And I do not believe that there is a contradiction between our strategy to prepare for ageing and our response to the crisis. In fact, our short-term strategy to exit the crisis entails putting in place measures that will support a more sustainable economy and society in the long-term.

You see a much bigger role for the IMF, would you say the same for the G20? Do you see it replacing the G7/8?

The latest events have shown that the G20 has a strong role to play in the face of the global economic crisis. This forum is more representative than the G7/G8 and able to engage emerging powers such as China, India and Brazil in the management of global affairs.

> *A consolidated representation in the IMF would make us more influential*

However, the nature of the current global crisis has shown that even a G20 may not suffice. The need for truly global governance will ultimately see the transfer of responsibilities and leadership to multilateral institutions, such as the IMF. Therefore, the presence and influence of the EU in such institutions is becoming crucial. Europe has played a decisive role in the global response to the financial crisis. This is because we presented a united front and spoke with one voice to our G20 partners. A consolidated representation in the IMF, with a single euro-area seat, would make us more influential in shaping the new world economic order emerging from the crisis.

What about Europe? What is the place of Europe in the global economy?

Even as the global landscape is changing dramatically, I don’t think anyone can question Europe’s central place in the global economy. We are the world’s largest economic power, our trade flows surpass those of the United States and the euro is the world’s second most important currency.

We have to capitalise on these assets to ensure that as globalisation progresses and new economic powerhouses emerge, we retain our competitive position in the global marketplace. This means greater investment in R&D and innovation, in skills and education and in creating a better business environment; all priorities that the EU has been advocating under the Lisbon Strategy. Moreover, Europe must continue to lead the way in the world’s battle against climate change.

Europe is also a key player in international financial markets. Our regulatory activity in the financial sphere influences standards and practices around the world. So we have a responsibility to drive forward the global effort towards a more stable and resilient international financial system.

Our tenth Forum

The euro marked its first decade as a currency in January. The Brussels Economic Forum celebrates its own milestone this year: its tenth edition.

The first Forum took place in 2000, as a platform to debate the EU’s economic challenges in a newborn Economic and Monetary Union.

It has grown in strength since then, with close to 1 200 participants registered last year, but its aim remains the same: to gather key players in an economic conversation, including government authorities, international organisations, financial institutions, social partners, academics and the media.

As the EU faces up to the economic crisis, this tenth Forum offers a unique opportunity to debate crucial issues concerning the recovery.

Preview | **Ageing and the long-term sustainability of public finances**

How bad is it?

Amidst concerns about the cost of taxpayer bailouts and fiscal stimulus packages, there is a far more serious issue looming on the horizon: ageing.

"The 2009 Ageing Report: economic and budgetary projections for the EU-27 Member States (2008–2060)" takes a comprehensive look at the long-term impact of Europe's ageing population on current policies.

The graying of society

According to the report, elderly people will account for an increasing share of the population whereas the population of working age (15–64 years) is projected to drop by 15%. Over the next 50 years, the EU will move from having 4 working-age people for every person aged over 65 to a ratio of 2 to 1.

This demographic trend is caused by three factors:

1. Fertility rates are expected to rise slightly across the EU but remain below the natural replacement rate of 2.1 births per woman that is needed in order for each generation to replace itself.
2. Life expectancy has been rising steadily and is expected to continue its upward trend.
3. Net inward migration to EU countries contributes to population growth, but is expected to decline over the long-term.

As a result of these trends, there will be more older workers and women in the work force, but the overall work force is expected to shrink by as much as 13.6% or around 33 million people by 2060.

Will the well run dry?

The reduction in the working-age population will ultimately act as a drag on growth. Annual average potential GDP growth rates in the EU are projected to decline sharply. Hence, while European economies will continue to grow, they will do so at much lower rates than have been experienced over the past decades.

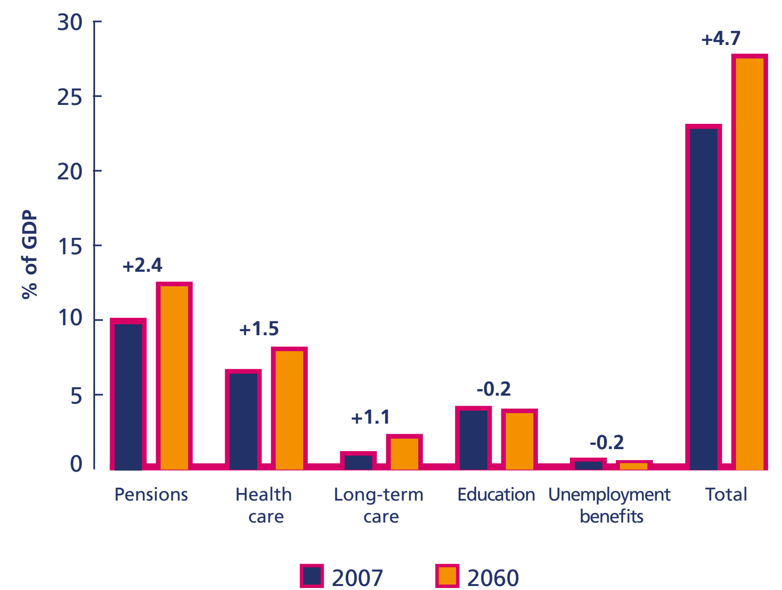
Moreover, the fiscal impact of ageing is projected to be substantial in almost all Member States. Age-related public expenditure is expected to increase by 4¾% of GDP by 2060 in the EU, with most of the projected increase for pensions (+2½% of GDP), healthcare (+1½% of GDP) and long-term care (+1% of GDP) (see graph).

No way out?

While the ageing of the population will impact all European countries, those that have reformed their pension systems are better positioned to weather the demographic storm. Making better use of the global labour supply through net migration can also help temporarily, provided immigrants are effectively integrated into the economy and society; however, they will also ultimately draw a pension. The Stockholm European Council of 2001 laid out a three-pronged strategy to tackle the challenges posed by an ageing population: (i) reducing debt at a fast pace; (ii) raising employment rates and productivity; and (iii) reforming pension, healthcare and long-term care systems. Further progress along these routes will enable countries to face the future with confidence. ●

Life expectancy at birth	2008	2060
Men	76.0 years	84.5 years
Women	82.1 years	89.0 years

Projected annual average GDP growth rates		
2007–2020	2021–2030	2041–2060
2.4%	1.7%	1.3%



Public/private: two sides of the same coin

Two experts give their views on ageing, pensions and the sustainability of public finances

Christian Kastrop

Deputy Director-General, Ministry of Finance, Germany, and President of the EU Economic Policy Committee (EPC)

"Contrary to common perception, the latest projections show that the size of the EU population will be roughly the same in 2060 as it is today. The difference is that the age structure is going to change dramatically. By 2060, the population is going to be significantly older, on average. This is going to put considerable strain on age-related public expenditures and could threaten the long-term sustainability of public finances. Politicians can anticipate such challenges, and, indeed, they must. There are many ways to soften the impact of ageing. We can, for example, remove barriers to participation in the labour market."

"As far as pensions are concerned, for capital-funded systems the most serious risks stem from the considerable loss of wealth associated with the financial crisis. For pay-as-you-go systems, on the other hand, a reduction in long-run growth potential may be more important. To ameliorate these impacts, first of all it's of utmost importance that we introduce measures to get the crisis under control. Then we need to put in place the necessary short-term stimulus for the economy. Finally, we need to start today to implement an exit strategy which takes into account the EU's long-term reform strategies such as Lisbon and the Stability and Growth Pact, as well as ongoing challenges such as climate change. Above all: let's use the crisis as a chance to steer our economies onto an even more growth-friendly and shock-resistant path."

Dick Sluimers

Chairman of the Executive Board of APG Group

"The sustainability of public finances is a major challenge. This is especially true for countries in which pension provision is largely dependent on public pay-as-you-go schemes. Many governments have decided to reform first pillar pension provision. As a result, state pension benefits are expected to decline by an average of 25% in the EU. In my view, occupational pensions are well-suited to supplement the decline in public pension replacement rates. Pension funds are able to provide retirement income security at a reasonable cost."

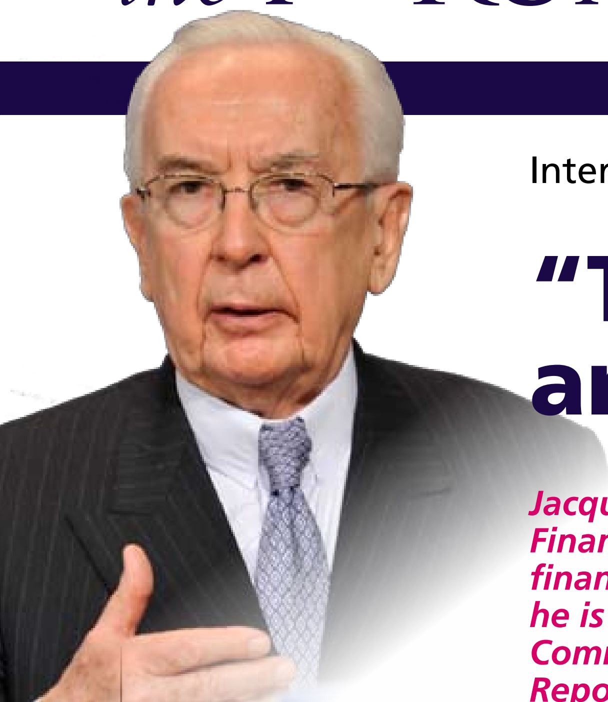
"I fear that the financial crisis will exert additional pressure on public pension provision. The economic contraction has already resulted in large upward revisions of government deficits. The billions of euros in state funds used to bail out banks and insurers have increased public debt.

As a consequence, governments will eventually be forced to further reduce government outlays. They can't keep spending *ad infinitum*. That's why, now more than ever, I'm convinced that funded pension systems are essential for providing European citizens with adequate retirement income." ●

Pensions at risk?

On top of the challenges posed by ageing populations, the adequacy and sustainability of pension systems are now also threatened by the financial crisis. Just as there is increasing reliance on private pensions in many EU countries, equity prices have slumped. By end-2008, the total assets of all pension funds in the OECD had declined by about USD 5.4 trillion.

Pension fund plans are long-term oriented. Nonetheless, until markets recover, there might be calls on public budgets to compensate. Yet public pension expenditures are already expected to rise to 2.4% of GDP over the period 2007–2060.



Interview | **Jacques de Larosière**

"The EU must set an example"

Jacques de Larosière, who chaired the High-Level Expert Group on EU Financial Supervision, is regarded as a global authority on international finance. A former IMF Managing Director and Bank of France Governor, he is currently an adviser to BNP Paribas Bank and the European Commission. In an exclusive interview, he explains why the 'de Larosière Report' calls for better – rather than more – regulation.

What lessons can you draw from this crisis?

JdL First, global imbalances must be reduced through adjustments to the political economies of the countries involved, i.e., the United States and other major creditor nations, with multilateral oversight to be provided by the IMF. Second, monetary policy must no longer turn a blind eye when asset bubbles occur. Third, assets should not be valued at one-day spot prices but should be evaluated throughout the cycle. Fourth, securitisation has become an excessively complex and opaque financial instrument and its use should be limited. Finally, supervisors and bankers must be retrained not to base risk assessments exclusively on mathematical models which have proven to be severely deficient.

How much regulation do financial markets need?

JdL What is needed is not necessarily more regulation but better regulation. The regulations in effect when the crisis hit and which are still in effect today have often given rise to misplaced incentives.

First and foremost, the Basel II rules on risk and capital management by banks require a thorough overhaul. Counter-cyclical rather than pro-cyclical regulation should be instituted – Spain's initiative on dynamic provisioning is encouraging in this area. There should be a greater focus not only on capital requirements but also on liquidity. Furthermore, financial institutions that operate like banks, including American investment banks and hedge funds, should all follow the same ground rules.

> *Reform efforts should not be weakened by the crisis*

Guidelines on trader remuneration should also be based on performance over the course of several years rather than annual performance. Finally, a clearing system should be established for derivatives, which are now sold in over-the-counter markets outside the established exchanges. This is particularly the case for credit default swaps.

What will the European financial landscape look like in five years time?

JdL The banks of the EU – particularly continental banks, which hold 80% of European banking assets – were much less involved in proprietary trading than their Anglo-Saxon counterparts.

As I see it, the trend towards concentration will continue for the next five years. And universal banks that employ strategies blending retail services to private customers, commercial lending, customer asset management and, to a certain extent, market activities, will be the models that survive.

What is your message to the Brussels Economic Forum?

JdL There are still many structural imbalances in the European countries. Reform efforts such as those advanced in the Lisbon Programme should not be weakened by the crisis.

The EU must set an example in terms of financial regulation and supervision. We still have a very fragmented system. If we quickly bring order to the system, Europe will be able to speak with a single voice and influence G20 decisions in this area.

A governing board on systemic risk made up of central bankers and supervisors from the Union should quickly be formed and placed under the aegis of the ECB. There was a notable lack of risk analysis in the run-up to the crisis.

The EU holds the largest share of the combined banking assets of Europe, the United States, and Japan. On this basis alone, Europe should have a strong influence in promoting sound global regulations.

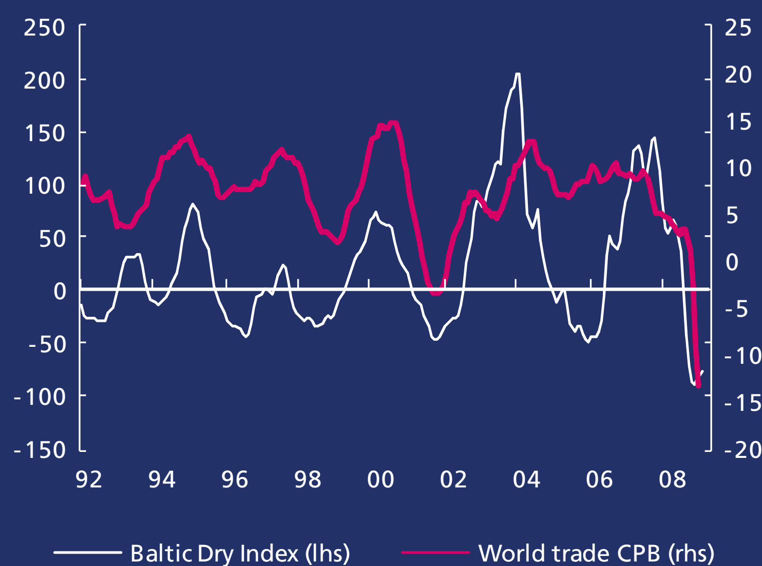
"What de Larosière says

THE DE LAROSIÈRE REPORT CALLED FOR:

- A European System of Financial Supervision (ESFS), a decentralised network to oversee day to day supervision;
- A European Systemic Risk Council (ESRC), chaired by the European Central Bank president, to establish an effective macro-prudential risk warning system;
- A review of the Basel II banking rules;
- Adoption of the Solvency II insurance legislation;
- A review of the credit rating agencies' role;
- Mandatory information requirements on hedge fund managers;
- Simplification and standardisation of over-the-counter derivatives;
- Common rules for investment funds.

A sharp drop in world trade

According to the Commission, a sharp contraction in world trade is one of the main factors behind the recession. World trade fell at an annualised rate of 24% in the last quarter of 2008 and probably a similar rate in the first quarter of 2009, rates not experienced since World War II. For export-dependent economies, notably in emerging Asia, this is particularly dramatic, with most of these small open economies experiencing double-digit contractions in exports.



Source: Spring Economic Forecasts 2009

Turning the tide: the EU's recovery plan

Over the past year, the European Union has made momentous moves to address the economic downturn and get back on the road to recovery.

The economic crisis has hit Europe – and the world – with almost unprecedented fury. But EU institutions reacted quickly, developing common responses to a broad range of issues.

It was last November that the European Commission unveiled an ambitious €200 billion fiscal stimulus recovery package. The two-year plan aims to restore consumer and business confidence, limit the impact on employment, improve the market conditions for banks, and promote green technologies.

Since then, the EU has also moved in collaboration with the IMF to provide billions of euros to help various countries weather the financial crisis. At the same time, the EU has agreed a substantial increase in IMF resources.

At their March summit in Brussels, EU leaders agreed to raise an emergency bailout fund for non-euro EU members of €50 billion. They also confirmed a €5 billion package of spending on renewable energy and broadband, which aims to help ensure a green and high-tech recovery in Europe.

In parallel, the EU has been at the forefront of efforts to repair and strengthen the financial system. More initiatives are planned. This month, the Commission is due to propose new financial supervision structures based on the recommendations from the de Larosière report; they should be confirmed at the June European Council, and the architecture should be in place by 2010. And the EU is working with its G20 partners for a breakthrough on the Doha Round of WTO talks in La Maddalena in July.

Thanks to its broad policy responses, the EU can look ahead to a turnaround: while the Commission estimates that real GDP will fall by 4% in 2009, it adds that the economy should recover gradually to reach "modestly positive" growth rates during 2010, in part due to the effects of the various recovery measures.

Cleaning up toxic assets

Cleaning up the troubled assets clogging up banks' balance-sheets is seen as a prerequisite of financial and broader economic recovery.

Toxic assets are blamed for paralysing bank lending and aggravating the recession. Moreover, the volume of impaired assets grows bigger as the recession deepens, and assessing it is a moving target.

According to International Monetary Fund Managing Director Dominique Strauss-Kahn, tackling toxic debt is a more urgent task than injecting cash into the economy with stimulus packages. "We are being too slow to deal with this topic," Strauss-Kahn says.

In the EU, the problem has been addressed with flexibility: Member States have agreed principles to ensure that toxic assets are not valued more highly in one country than in another, but they do not have to use the same methods to actually clean up such assets.

Similarly, at the G20 summit in London, leaders agreed to remove toxic assets from firms' balance sheets, although the exact methods remain up to individual countries.

Profile | **Anders Borg**

Fiscal Ironman

Swedish Finance Minister Anders Borg is best known as an advocate of fiscal discipline. He has warned that weakening the rules regarding budget discipline will "lead to significant problems for a long time to come". According to Borg, even before the financial crisis, public finances in many countries were not sustainable in the long-term in light of Europe's ageing population. Borg believes that most Member States will enter the next economic downturn with a larger debt burden than they have today, and cautions against relaxing the rules governing the Stability and Growth Pact.

Borg is recognised as the architect of the Swedish government's economic doctrine, and has overseen an incremental dismantling of the social democratic welfare state. He started his career as an editorial columnist at Svenska Dagbladet (a Swedish daily newspaper), was political advisor to Prime Minister Carl Bildt, and worked in the private sector for Skandinaviska Enskilda Banken (SEB) and as Chief Economist for ABN Amro Bank in Stockholm. Borg was adviser on monetary policy issues to the Executive Board of the Riksbank (the Swedish central bank) and chief economist in the Swedish Moderate Party before assuming his current post as Finance Minister and European Investment Bank Governor for Sweden. •

Anders Borg will speak today in the panel on 'Ageing and the economic crisis' (16:00–17:30)

Profile | **Mario Monti**

"No taxation without coordination"

Mario Monti is President of Bocconi University, Milan. He is a member of the Reflection Group "Europe 2020–2030", set up by the European Council and chaired by Felipe González. He is also honorary president of BRUEGEL. He served as Commissioner responsible for internal market, financial services and taxation (1995–1999), and as Commissioner for Competition (1999–2004). In the latter capacity, he gained the 'Super-Mario' nickname as Europe's 'neatly-tailored' anti-trust czar who forced Member States to rigorously comply with state aid rules, blocked the merger between General Electric and Honeywell, and placed sanctions against the anticompetitive behaviour of Microsoft.

Monti has recently put the global economic crisis into a larger perspective. He sees it as a challenge to the market economy model, globalisation and European integration. "There are political forces at work that are trying to use the crisis to turn the clock back … to impose failed recipes based on failed ideas," he warns. Unlimited tax competition urgently needs to be addressed, according to him, because it reduces the ability of each country to use its budget for redistribution to reduce inequalities.

Monti believes that the convergence of the social market and Anglo-Saxon economic models, as a response to the crisis, provides an opportunity for compromise. Full tax harmonisation is neither feasible nor really necessary, according to Monti, but tax coordination would enable countries to pursue social objectives while respecting the rules of the single market. A pact on tax coordination would "give new vigour to the faltering European project". •

Professor Monti will deliver his keynote speech today at 10:00

Europe and the crisis, as seen by last year's speakers

"With recent turbulence euro financial markets were disrupted, along with dollar markets, but the dislocation would have been much more severe without the euro."

MALCOLM D. KNIGHT, DEUTSCHE BANK
(former General Manager of the Bank for International Settlements)

"The euro reduces the vulnerability of euro-area economies."

DOMINIQUE STRAUSS-KAHN, IMF

"We have just witnessed the biggest consumption binge in history and we are now looking at several years of Japanese-like behaviour with sluggish and anaemic growth. And the EU has no special dispensation from this crisis."

STEPHEN S. ROACH, MORGAN STANLEY ASIA

On our bookshelf

The European Commission's Directorate-General for Economic and Financial Affairs (DG ECFIN) publishes many reports and analyses on EU economic issues, which can be downloaded from the DG ECFIN website. Some of the latest publications are freely available at the stand outside the conference room, such as:

- The *Spring Economic Forecasts* published on 4 May 2009
- The *Ageing Report 2009* – included in the participants' bag – as well as the accompanying Statistical Annex and Commission Communication, adopted on 29 April
- The report, *'Five years of an enlarged EU'*
- Some of the most recent *Economic Papers*

DG ECFIN also publishes two newsletters which you can subscribe to free of charge: the *European Economy Research Letter* and the quarterly magazine *European Economy News*. If you would like to receive any of them, please fill out the subscription form available at the stand and hand it to the organising team during the Forum.

In addition, DG ECFIN maintains a set of economic databases, which can be freely consulted on its website, such as AMECO, the annual macroeconomic database; BACH, the bank for the accounts of companies harmonised; LABREF, the labour market reform database; and MICREF, the microeconomic reforms database. You can find more information about these and other databases at the same publications stand. •

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