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Il a prononcé un discours dans le cadre de la première session du forum, intitulée "*Europe and the global economy: challenges, options and policies*".

You have asked me to speak about the global economic situation and about regulatory issues. I will deal with those questions in succession.

I – Global economic situation

In spite of the severity of the global recession and the rapid deterioration in unemployment, there have been some objective signs of improvement over the last weeks : consumption appears more resilient than had been expected, real estate data in the U.S. seem somewhat better oriented, banks' access to liquidity has eased, interest rates are lower, the Chinese economy is picking up…

There is thus some moderation in the pace of the recession, but this not to say that the recovery is at the corner. It is hoped that things will start turning around in 2010 but the recovery may well be weak and below potential for some time. I would like to add some observations on the speed and the intensity of the deleveraging process.

I believe that the most indebted parts of the private sector will suffer most. If you look for instance at the US's total private sector debt ratio to GDP, you see that in 1976, which was a year of relative historic stability, total private debt to GDP was 112%. In 2008 it peaked at 295%, so it is a quasi-tripling. And if you look into what happened to the financial sector, it went from 16% in 1976 to 121% of GDP in 2008. So one has to understand that the financial sector in the United States has become enormously indebted and dependent on the markets.

And if one observes for instance the mortgage debt of households in the United Kingdom related to disposable income, one sees that in 1991 it was 80% and in 2008 it was 140%. Whilst in France and Germany the figures were around 50%, and are now in the order of 70%. So I think that, in this world of uncertainty, it is safe to say that this crisis, being an over-indebtedness crisis, will affect probably more those countries and sectors who are very highly indebted and leveraged and will to some extent spare the parts of the private sector which have kept more reasonable ratios.

One can say this in another way, which is that much will depend on the speed of the rebuilding of savings in the United States. One knows that household savings related to disposable income were zero for quite a while. Today, because of the crisis, they have come back to 4%. The historical figures are around 10% or a little more. Thus the strength of the recovery in the United States will very much depend on how savers under the present conditions are going to see their wealth evolve and are going to regain a more reasonable level of savings. Will it be 10%, 11% or 8% ? I don't know. But that is a substantial factor in what is going to happen.

Concerning the banking system, I think that the situation is very diverse and that institutions have been very differently affected by the crisis. There are some European banks that have been more inclined to follow the American investment bank model and got heavily involved in proprietary trading and transacting in what became toxic assets. But others, especially on the continent, but not always – sometimes on the continent they did engage in very dangerous business – have kept a model that is more balanced with a large retail sector in domestic markets, corporate banking, asset management, investment banking but tied very much to the needs of clients. And those banks, I happen to think, have a good future because of their business model. They are already making substantial profits in part because of the very low short term interest rates that central banks are providing and they are building-up reserves in the right way, i.e. because of their profitability. One might not see that in those parts of the financial sector that are more engaged in toxic assets and therefore in cleaning-up operations.

Finally, a few words on the issue of exit strategies. It is clear that substituting –as is the case- huge public indebtedness to the shrinking of –unsustainably high- private debt is not going to cure in the medium term the problem of overleveraging. This policy has indeed its shortcomings and limitations.

If governments were reluctant –as soon as the global economy starts picking up- to return to balanced budgets, and if central banks were hesitant to cut back their easing, the risk would be a rise in inflationary expectations. This turning point in present policies will be crucial. Too prolonged fiscal and monetary expansion could feed a return to stagflation which is the worst of all combinations. The ability of governments to continue to run large deficits will, in any case, be limited by the cost of financing them. Those countries with large debt/GDP ratios will be the most vulnerable. If markets lack appetite for treasury instruments, the resultant rise in long term interest rates could harm the recovery. Therefore, the way the conduct of exit strategies will be handled will have a decisive role on expectations and on future economic and financial developments.

II – Regulatory and supervisory reform

I am not going to sum up the report of the panel I chaired. It is on the website and it has been discussed. I would only like to underline two issues.

The first one is that the report focuses on the misleading incentives that had contributed to the crisis and that characterised financial regulation, monetary policies in the preceding years. We have to have in mind that the lack of multilateral surveillance on structural current account imbalances was one of the most salient features of the very roots of this crisis. The structural deficits of the United States which went on and on and on and reached some 5% to 6% of their GDP, combined with a huge accumulation of reserves - which meant exchange rate intervention - in emerging economies, have led to very high liquidity creation, leverage and low interest rates. And those liquidity conditions were not counteracted by an active monetary policy in advanced countries. On the contrary, monetary policy was lax and led to very low interest rates, actually sometimes negative or zero in real terms, which of course encouraged financial actors and investors to lend and to borrow. And if one combines that with some aspects of financial innovation, and what can be called the “abuse of securitisation”, that explains the massive bubble of credit. The reliance on the idea that markets would always provide liquidity to the vehicles that contained those types of innovative complex and often opaque assets became a terrible illusion when the sub-prime crisis erupted, when liquidity vanished and the whole superstructure of these immense heaps of leveraged instruments fell apart.

Now, what the report says, and this is a rather obvious observation but it is worth repeating, is that the crisis is not the result of a regulatory failure only. If we believed it, then we would no doubt make big mistakes in the way we handle the future. The root causes of the crisis are to be found in large imbalances, loose monetary policies and in the lack of multilateral surveillance.

The second issue highlighted by the report is the fact that the system of financial regulation combined with the accounting rules that had been imported from the U.S. into Europe some ten years ago, led to very dangerous incentives. Too much reliance on faulty risk-assessment models, too much immediate full-recognition of mark to market asset prices, without discounting for future losses "through the cycle", etc. All this led to very short-term behaviour and was also accompanied by a number of loopholes in regulation, like the absence of monitoring off balance sheet operations. Of course these shortcomings encouraged all sorts of off balance vehicles that proved very dangerous.

One could also note strange limitations of capital requirements on proprietary trading assets while it should have been the reverse. No regulation of any substance on a number of dark pools of assets or hedge funds. Too much reliance on risk assessment models that were based on erroneous assumptions… I could go on and on, the list is in the report.

So these are sobering thoughts. Our idea is not to just propose to add more regulation on layers of past regulation. If the layers of past regulation have been misleading, which they have in many cases, then one has to overhaul those misleading incentives and change them. So it’s not more regulation, it’s better regulation in cases where the facts show that the regulations have not been effective.

Some may say ‘Yes, all this is good for the future, that’s for after the crisis; what is important now is to clean up the banking system and get things going’. But that was not our mandate, which was to focus on the post-crisis reform. These reforms are essential and urgent. We need to be prepared for the new slippages and the new systemic risks of tomorrow.

We already see bubbles and a return to questionable practices emerging in some parts of the world that give rise to concern. We have not already achieved a regulatory environment and a supervisory efficiency that can provide stability to the system. So it is very urgent to act. It reminds me of an observation by Maréchal Lyautey. He wanted to plant an oak tree in his park in Morocco, and his gardener said : (Lyautey was already an elderly man) “An oak tree will take 40 years”. Lyautey replied “Is that so, then it’s urgent, you have to do it now” That is exactly the situation that we are in.

What are the most important aspects, and I will close on this, of the regulatory reforms that we are proposing in our report ? I will put them on a global level because we live in a global world and I don't think it would make much sense to limit our effort to Europe alone. So I am just going to cite a few headlines.

We should try to eliminate as much as we can systemic pro-cyclicality in financial and accounting regulations. I think that there is an emerging agreement on this. It will be very important for the Financial Stability Board to address that issue.

We have to close some loopholes that are unacceptable : unregulated off balance sheet operations and some aspects of hedge funds activities. The Commission is working on that and has already started. We have to have a set of rules that are consistent, not necessarily identical but consistent, in order to avoid regulatory arbitrage, to avoid the temptation to "choose your regulator". And here also the Financial Stability Board should play, like the G20 has recommended - and we had in our report – a very important leading role.

I believe that we should also supervise in a consistent way cross-border groups. This is one of the main recommendations for our European work. There are cross-border groups in Europe, in Eastern Europe in particular. It is very important to get host- and home-regulators together, and to build colleges that are really working colleges. On the global plane we must generalise these colleges for cross-border groups and introduce more coherence in the way they are supervised.

We have to give some more powers to supervisors. And here the combined role and collaboration of the FSB and the International Monetary Fund is of the essence. The International Monetary Fund has embarked over the years on "financial sector programmes". They are extremely important but I don't think they are sufficiently exploited. They should become part-and-parcel of the strategic policies of the IMF. They should be compulsory of course for all member states and should be an integrated part of the Article 4 reviews of countries. That is something very important, because if one sees that in a particular case the, the 'coherent rule setting system' is not being applied, then the IMF has some substantial powers to make it public, and to react.

I would end my list with setting-up a macro-oversight approach to avoid the repetition of these awful events.

Some might say that there were macro-oversight mechanisms. Yes! In a certain sense there were, but they lacked precision, they lacked specific recommendations and they lacked accountability. What we have proposed in our report for Europe, and I think that is transposable into the general system, is to build under the aegis of the ECB a group of central bankers, plus supervisors and the Commission, who would not only analyse looming systemic risks but also propose early warnings and recommendations that would be applicable by a number of entities concerned, be they Central Banks, Governments or supervisors. This did not exist in the present setting and that lack was a major deficiency in the functioning of the international financial system.

To conclude, I think that the European Union should act very quickly on the report. I am very happy to see that the Commission is very seriously engaged in that exercise. It has made precise proposals based on our report at the end of May and those proposals will be discussed in June by the Council. It is important to act swiftly.

It is also important to avoid postponing the difficult parts of this compromise – I liked Mario Monti's allusion this morning to a sort of historical compromise between market economies on the one side and social policies on the other side. I think we also have a historic window of opportunity. This report is a very moderate report. It does not recommend for instance the creation of a supranational body to supervise the financial system in Europe. It considers that national authorities can do the job pretty well. But it does propose a modest enhancing of the authority of what we call 'Level Three Committees'. And one of the things we propose, and which I would really like to be safeguarded in the decisions to be taken, is the possibility, when you have a conflict between a host- and a home-country within a college, to give to the revamped level 3 committees CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors), CEBS (Committee of European Bank Supervisors) and CESR (Committee of European Securities Regulators), who would become "authorities" as we suggest in our report, to give them the power to act and propose binding mediations, in case of divergences of views.

Now this is a modest incursion of a supranational nature. Very modest, it has indeed been delineated in the most prudent way. But if in 2009 in the middle of all this mess, Europe is not able to surmount some of its slight differences – because others would have liked a much more ambitious scheme - if we are not able to get together on a reasonable compromise – then we should forget about it ! In that case, after four months spent on that report, it will end on a shelf and dust will fall on it, and we will have been losing, vis-à-vis the G20, the international community, one opportunity which is absolutely unique for Europe : to be heard and have some influence.

We can propose at the global level a system which we have decided to apply ourselves and which can be a sort of a blueprint for the international system at large. I think that the Americans are counting on our ability to pull our act together. Up until now, when you speak to an American or an Asian official or businessman, he says 'Yes! Europe, you have a lot of ideas but you are always disunited and fragmented, you never agree on anything' – that is too often the image of Europe. If we can, through this very reasonable report, if we can pull our act together, then Europe will have much more credibility in the system.

This is true also for the macro oversight proposal we made. I see positive reactions from the United States; they say that this is exactly what they want to do at home, and if they do it and if we do it, then we can start discussing bilaterally, plus with Japan, plus with Asia. Then the system becomes a true system that will be crowned by the Financial Stability Board and the IMF. One has to have it as a bottom-up approach. Because if it is only a top-down approach, if it is the IMF that says things, that is fine but it is not sufficient. You have to have central bankers and supervisors in the world looking at the horizon and detecting what may be going wrong. That is the bottom up approach that must become the multilateral one.

Basically, that is what I wanted to say. I would like to thank the Commission for the way it has received the report, which has been very positive. The Parliament has been also extremely cooperative. And I hope now, at the level of the Council of Ministers, we are able to surmount what I would call traditional little differences. So thank you very much, and let's hope !