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Charlie McCREEVY, European Commissioner for Internal Market and Services
The current global economic crisis, Leinster Society of Chartered Accountants (LSCA), Dublin, 8 May 2009[1]

Good afternoon Ladies and Gentlemen:

I am delighted to be here with you once again today and to have the opportunity to share with you my thoughts on the current global economic crisis.

It is a crisis that has many dimensions. But I want to concentrate on those aspects which give me cause for most concern.

My primary concern is with the state of the global financial sector and in particular the impact on it of the negative feedback loops that are now in evidence in the real economy. It is inconceivable that the recent scale of the falls in output, of the rises in unemployment, and of the collapse in global trade will not have a serious negative impact on what one might call banks' real economy customers - and therefore on the extent of the banks' next round of bad debts. In turn the impact of that on the banks' capital bases and therefore on their ability to finance economic recovery - without further government injections and support - must be a real concern for policy makers and supervisors everywhere.

To repair the financial sector fully is a herculean but urgent task. It requires removing remaining strains in funding markets, repairing bank balance sheets in a way that is credible and durable, restoring cross-border capital flows, and limiting the unintended side effects of the policies being implemented to combat the crisis.

None of this is easy. None of it can be done in isolation: It requires strong international cooperation and demands strong political leadership.

Without a significant further cleansing of bank balance sheets ? accompanied by restructuring - there is a real risk that the banks' problems will exert continued downward pressure on economic activity through the curtailment of the provision of new credit.

On the positive front tightness in inter-bank markets in recent months has eased considerably. However, funding strains persist and banks' access to longer term funding as maturities come due is diminished. As a result many companies struggle to obtain bank-funded working capital or long term debt other than at very elevated yields.

Aggravating the situation further are the problems in the pension fund market and the insurance industry - with pension funds hit hard on both the asset and liability side: Massive falls in asset values have combined with lower government bond yields that are used to discount liabilities to substantially expand pension fund holes. Life and other insurance companies too have suffered substantial losses in equity and corporate bond holdings. This in turn is putting pressure on their regulatory capital surpluses.

A sharp decline in cross border funding is intensifying the crisis in emerging markets : The withdrawal of foreign investors and banks as well as the collapse in export markets is creating funding pressures in those markets that also require urgent attention.

As far as advanced economies are concerned, despite unprecedented official initiatives to stop the downward spiral ? including fiscal support, massive capital injections into the financial sector by government, as well as substantial liquidity support - further measures will be necessary to help restore confidence and relieve the financial markets of the pressures that are undermining the prospects for economic recovery. However the transfer of risks from the private sector to the public sector poses serious challenges.

Unintended distortions and open ended bank support packages are likely to combine in many countries with strong upward pressure on government debt burdens to push public debt levels to close to unprecedented levels in advanced economies.

This brings me to another concern which is the potential for crowding out in the sovereign debt markets. The impact that that may have on gilt yields and longer term interest rates could be considerable. This danger makes it all the more important that governments face up to the very difficult and painful process of fiscal consolidation ? difficult and painful especially at a time when citizens are facing so many pressures from so many different quarters. On fiscal consolidation I want to make two points: First from the perspective of retaining credibility in the international capital markets it is important that governments with deficit problems are seen to take decisive and meaningful action - in good time - in order to retain market confidence. Only in that way will they minimize the spreads that have to be paid over and above the benchmark rates for the strongest euro area economies. Second, we must recognise that fiscal consolidation based on spending cuts is, as evidenced by historic experience, almost invariably more successful than fiscal consolidation based on tax rises. Of course crafting spending cuts in a sensible and meaningful way takes longer than crafting tax rises.

There is now, I believe, a recognition that increased tax rates on high earners can very quickly produce diminishing returns. All governments face the pressures to make the rich pay more. But it is essential that we remain focused on the dynamics and human nature that drives risk taking, economic activity, and tax revenues forward. And that we guard against policies and tax rates that drive risk taking, economic activity, and tax revenues backwards: Entrepreneurs' and risk takers' decisions are very often made on the margin - based on confidence levels, the investment climate, and of course the likely post tax return. That?s why we need to keep tax rates low. Let's not forget that those with the highest incomes are also those with the most capacity to take risk, to create new businesses, new employment, and new sources of tax revenue. Put simply, it is not higher tax rates that generates higher tax revenues. It is higher economic activity that generates them: And it is risk takers who generate higher economic activity: The choices those risk takers face are whether to take risk, when to take risk, and where to take risk - and hence where to pay their taxes. We can sink or swim. But if we lose sight of these simple facts we will certainly sink.

This brings me to another point: There is no government here ? or anywhere else ? that can conduct the necessary fiscal retrenchment without becoming politically very unpopular. I can think of no time in our history as an independent State when setting aside party political differences would make more sense than it does today: There is too much at stake for the normal, business?as-usual "Punch and Judy" politics to continue to hold sway. It is readily obvious that there is broad consensus on the direction in which our economy should go. In these extraordinary and quite dangerous times, do we want to emerge from this crisis quickly and strongly through a tough, difficult, but more consensus approach that would lift the confidence of capital markets and reduce the cost of the significant levels of debt that we now have to raise? Or do we want to increase the risks to our political and economic stability that the dynamic of the party political game renders inevitable in times such as these, which in turn results in a much longer period of adjustment at much greater expense to the taxpayer and to the next generation? The sooner a debate is kick-started on this issue, the better.

I can understand why people right across Ireland-and other countries - are angry at what has happened. Many don't understand why it happened or why it was allowed to happen: The answers are complex. Much of it had to do with excess liquidity in the global financial system, over-complex financial engineering and innovation, and an absence of adequate supervision - at both a macro and micro level. I want to lay to rest one myth ? that it was because of a lack of regulation: On the contrary much of the regulation was there. It simply wasn't enforced. That?s why supervisory structures and supervisory resources and expertise must be and will be strengthened. Lessons have been learnt and they must be acted upon.

It would not surprise me if there was a widespread view that bankers and property developers - here and elsewhere - should be taken out and "tarred and feathered". But we must not lose sight of the fact that for our economy to recover, experienced bankers and experienced property developers will be needed. Whether we like it or not many of those who have been chastened and bruised by the experiences of the recent past are probably also those who have learnt most and some of them may therefore be best equipped to manage and handle the many challenges of renewal that lie ahead. Let's not throw out the baby with the bath-water. Let's focus now not so much on past mistakes but on past lessons. Let's learn from the things that were done well ? and there were many ? and from the things that were done badly - and there were many of those too. Above all, let's remember the fundamentals that drive success. And avoid the pitfalls that guarantee failure.

I am confident that, with a more united approach towards economic policy making and the goal of national renewal, this country's economy can emerge strong once again. In fact I am in no doubt that Ireland can be one of the great post-crisis success stories of the European Union. Let's set aside petty, historic differences and do what is necessary to make it happen.

Tags: Basel III [3], MCCREEVY [4], Transparency [5]

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