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The European Debt Crisis

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Featured Speaker:
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Minister of Economic Affairs at the Embassy of the Federal Republic of Germany

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MATT BENNETT: Hello, everyone. I want to encourage people who are still in line to go ahead and get your food. If others of you haven't gotten food, please do so. But we figure your time is valuable, and we'll go ahead and get started.

One of the oldest clichés in economics is that when the United States sneezes, the rest of the world catches a cold. And of course, these days the U.S. is a little bit under the weather economically, but it's Europe that has pneumonia. And in this era of globalization, the contagion now moves very rapidly across borders. And that's why we have a room full of people in the U.S. capital for a discussion about Germany's perspective on the Europe economic crisis – because all of you know, now all too well, that Europe's ills are starting to reach American shores. And what will happen there is going to profoundly impact what's going to happen here.

My name is Matt Bennett. I'm a co-founder and senior vice president of Third Way. It is our pleasure and honor to welcome all of you to this session of Third Way's Capital Markets 101 series. As you may know, the Third Way Capital Markets Initiative is designed to promote balanced, nonpartisan and above all informative and accessible information about the financial markets to people on the Hill. This series of lectures and discussions has featured speakers from a very wide range of perspectives. We've had former Fed chairman Paul Volcker, former FDIC chair Sheila Bair, Moody's chief economist Mark Zandi, and the author Bethany McLean and many others.

If you've been to these before, you'll know that the only bias that Third Way is bringing to these discussions is our belief that a healthy, well-functioning financial system is good for the United States, benefits our economy, and it benefits average Americans. And it benefits average Greeks and Spaniards and Germans as well. The rest – what you'll hear today, what you'll hear in other sessions – is completely up for debate. And we welcome that debate, and we hope that you'll participate in that debate after our speaker finishes up his remarks at the top.

So as I mentioned, there's food. Eat now, eat later, whatever suits you. There will be a period for Q-and-A after the speaker is done. For your future planning, our next event is

September 21st. It's going to be The Wall Street Journal's economics editor, David Wessel. If you didn't get it on the way in, please take on the way out a copy of our recently released cheat sheet on Spain. It's a short document, and it kind of goes over what's going on in Spain, and it's very relevant to this discussion today. And of course you can get Peter's PowerPoint on the way out as well.

And of course thank you for coming. This is really a tremendous turnout by busy Hill staffers from Senate and House Republicans and Democrats, and we're delighted to have you all.

Our special guest today is Peter Fischer. He has a really unique perspective on the European debt crisis. This session is going to provide his insider's look into the debate that is going on not just in the grand capitals of – and corridors of power in Europe, but in the streets of Athens, in the pubs of Dublin, in the piazzas of Florence, the factories of Bavaria. It's going on everywhere, and it's starting to come here.

Before coming to Washington, where he now serves as head of economic affairs at the German embassy, Mr. Fischer had postings all over the globe. He was the head of the Department for Economic and Financial Policy in the foreign office in Berlin. He was the deputy ambassador in Israel, the economic counselor at the embassy in London, the deputy consul general in Shanghai, and he began his career in Singapore. And in addition to offering an international perspective on the European debt crisis as a diplomat, he also has an extensive academic background in this field. So we are delighted and honored to have him and look forward to his presentation.

And with that, I give you Peter Fischer. (Applause.)

PETER FISCHER: Thank you very much, Matt. Good – well, good morning, I think I can still say, ladies and gentlemen. I'm delighted to join you and speak a little bit about the euro. Matt, in your introduction you mentioned palaces in Florence, I believe, pubs in Dublin, streets in Athens and factories in Bavaria. Just wanted to mention that in Bavaria we also have palaces, we do have pretty good pubs, and we have public streets as well. (Laughter.)

I brought along two sort of real, flesh-and-blood German Europeans and – who are interns in Washington, DC. And if I describe them to you, you'll see the point that I'll come back to later, why Germany and Europe are a pretty good place and a good place to live. So there is Lisa Unsne (sp). She's a master's student in a – in a euro master's program. She's studying politics and management. And it's a consortium of 12 universities. And she has studied in Bath in Britain – Bath – (changes pronunciation) – maybe is the proper way to say it – and Paris. And then I think she's off to Siena in Italy and Madrid too. She did her undergrad in Ingolstadt in Bavaria, where Audis are made. And while doing undergrad, she went off to UCLA.

And there's another young intern – Lisa's (sp) interning at the embassy in the economics department. There's another young intern; his name is Stefan (sp) Fischer. He's interning with the office of Daimler AG, who build very good automobiles and other good industrial products. He was born in Singapore. He's a student at the University of Aberdeen in Scotland of business administration. Graduated from an American high school in Tel Aviv, and now he's doing an internship here. Happens to be my son, too. (Laughter.)

Now, I'm going to speak about the euro. The euro is a huge subject. There are many different aspects to it, many different angles and perspectives from which you can view it. It's in the news every day, and every day the news covers a different angle. So it's easy to get confused and to lose, like, an overview of what is actually happening there. And my goal today is I would like to contribute to your understanding of the situation.

I'd like to speak a little bit about where did this euro crisis come from, why is it important, what elements does it consist of – and try to kind of pick apart the different elements that are part of it. And to understand the different elements, it is important to understand what approaches are – play a role in trying to solve this crisis. And I won't be able to cover all the angles in my initial remarks, but there'll be time for question and answers to go into depth on any issues that are of particular interest to you.

Now, of course I'm not an academic observer. I have a partial view. I'm here on behalf of the German government, so I will give you the German government's view on this issue. And I'd like to formulate my take-home messages right up front. This is the – what the German government has to say and what I'd like you to remember. First of all, the euro is here to stay. It's not about to collapse. It is much less a crisis of the euro as a common currency than it is a crisis of financial stability in the eurozone. We need to – it's important to differentiate. Is the currency – the setup of the currency – is that in crisis and unsustainable, or is there a crisis of financial stability in the area where we use the currency? And my point is it's more the latter than the first.

The euro's actually doing OK. The exchange rate since the inception of the euro has been stable. It's kind of low right now, 1.22 to the dollar. But that's still much higher than its all-time low. So currencies, the exchange rates go up and down. In the state of where it stands now, there's nothing dramatic, from our point of view. The eurozone has experienced record-low inflation since the beginning of the euro. And the euro is well-respected as a reserve currency: 26 percent of global currency reserves are held in the euro. So, yeah.

The German government is committed to the cohesion of the eurozone and the stability of the euro. And so, by the way, is any realistically conceivable other government in Germany. The opposition in some ways criticize the government. They say, you're not committed enough. The government says, we're 110 percent committed. And they say, you should be 150 percent committed. So regardless – we have Christian – we have – well, we have – regardless which constellation will form the next government, they will be just as committed.

And the other eurozone governments are also committed. Please note that there isn't a single government in the eurozone that says, we want out. And Greece just voted in a government that said, we want to stay in.

I – and I – oftentimes you hear people write and talk about that the crisis in the eurozone is supporting the growth of parties at the far left and far right margins of society, extremist parties, maybe anti-European parties, populist parties. I think that is greatly exaggerated. Throughout – since World War II, in all of the European democracies we've had that discussions. We've had these marginal parties. They come up, and then they kind of fizzle out again. But the consensus in the middle has stayed strong, and the consensus now is, we are committed to the cohesion of the euro.

And the conclusion, which I will say now and come back to at the end of my talk, is that we are using this crisis to improve on some of the challenges that the euro faces and to correct some of the deficits which were left when the euro was born. Some people speak about birth defects of the euro; I'll go into it. And it – so we're going to use this crisis to improve, and we will come out stronger at the end.

Why am I confident? Because we have the will and we have the resources. And the will is a – is a really important point which I would like to emphasize, because it's frequently underestimated in the discussion in the United States. The euro, to all of us in the eurozone, is not just an economic, financial issue. It's not just a currency. But the euro is a – forms part of the foundation of the European project, the project of European integration. And European integration is the basis of peace, stability and prosperity in Europe.

And we are all deeply committed to it. And I will say from a German perspective, European integration was our path back into the circle of civilized nations after World War II and the Holocaust. And that's also deeply embedded in our political consciousness. So the will is absolute to – not to threaten the European project. I'll come to the resources part later.

So if we use the crisis well, we improve our situation. We will continue, then, to be the best and most important economic partner for the United States of America. And that's also a very important point, because we are – the EU and United States of America are two of the biggest economic areas in the world. Together they are the biggest. And together they share something which we don't share with some of the other big players, and that's shared Western values: individual liberty, democracy, human rights. So we're old friends and partners, and we should stick together.

Now, sure, our process of addressing the challenges is complicated. There are 17 sovereign nations that share the euro as a common currency. Each of those nations has domestic politics. Many have coalition governments. So everybody has to make sure their constituents agree with what they're doing. And that's true for Germany too. And I – you know that part of the discussion is: Is Germany ready to commit its money to help stabilize – save, as it were, some of these struggling European countries? Or we could put it in another way: Is Germany ready to mutualize risk and debt with other members of the eurozone? Or to put it in very simple terms: Are we ready to share our good credit with others in our family that have poor credit? (Scattered laughter.) And that's the key, really, to the story.

And the point I'm trying to make here is that's a political issue too. And it's by definition not popular to share your good credit with a lousy creditor in the neighborhood. So we need to – we need to be aware of domestic politics too. We need to convince our populations of each and every step that we take.

Our process is messy. There are huge legal issues involved. There are such things as treaties that need to be observed. And if we go for radical changes, we need to rewrite the treaties and ratify them through parliaments and so on. And even the management of this whole process really takes us to the limits of management capacity. You all know these famous European meetings that go all night. Somebody has to prepare all the economic, legal, management work that goes into it, and our leaders need to be able to keep awake until 4:00 in the morning and make sure they come to a good agreement.

You know, there's a famous saying – don't watch making laws and sausages; both are not very appetizing. But that certainly is true for European legislation. But in the end it works pretty well. And when I came here last fall, you were debating the debt ceiling. (Laughter.) And then something happened in Europe. The New York Times had – (inaudible) – said, "Another Messy Compromise in Europe." And I thought to myself, look who's talking. (Laughter.)

So – now, this is the first slide. I just have a few slides to – this is the first slide. There's a lot of criticism of the German government. There's a lot of criticism here in the United States of the German government. You – what does the slide show us? The world economy's under water and sinking fast. And the only reason that it's that way is because Mrs. Merkel does not want to start the engine. So it's a commonplace notion that Germany has the power to solve the euro crisis, and it would be only a question of if and when Germany delivers. And the critique is, you haven't delivered. You've got the power; all you need to do is start the engine; the boat will go out. And whatever we do is always too little, too late.

Now, politely said, that's a bit simplistic, and it's too simplistic to be accurate. You could also say it's just plain bogus. And what I'm going to try to demonstrate to you is that we have delivered a lot and that we are prepared to go – to deliver a lot more. And – but there's a key take-home regarding German policy on that. And the take-home is it matters what you do first, what you do second and what comes last. There is an issue of doing things in the right order and at the right time.

And we'll talk about the tension that exists between sound economic principles, in particular the fundamental principle of a free market economy, which is every economic actor is liable for his own economic actions. Without that, well, you have socialism, which we don't want in Europe, which we got rid of in Europe 20 years ago and which some of your bosses dread could swap over from Europe to the United States. But we don't want that either, and we don't have it.

So there's a tension between liability of economic actors and then the equally important principle of solidarity in times of urgent need. And if I can just create the picture of a family, and you've got one – let's call him a brother, who keeps overcharging his credit card. And the family gets together once, twice. And they said, listen, we'll lend you $500; we'll lend you $1,200 so you can balance your checkbook. But you really have to improve your act. That's the solidarity part of it.

But what if you do – if you – if he doesn't improve his act, if he keeps overspending? Then you need to start to face tough decisions. How often can you bail him out, and what incentives are you creating for him if you bail him out? Will he say, OK, understood, you bailed me out, I'm grateful, I'm going to improve my act, I will watch my finances and budget carefully and this won't happen again? That would be a desirable outcome. Undesirable outcome would be if he said, oh, no matter what I do, my family will always bail me out. And at some point, you may come to a point where you say, what are we going to do this for this guy, kick him out? What if he's sitting on your doorstep hungry? So there's a tension between sound economic principles, setting the right incentives, avoiding wrong incentives and solidarity. And I'll come back to that.

And the German government's key point is that solidarity is an essential part in the eurozone, and we are practicing it, and we will practice it even more, but the solidarity makes no sense if we don't address the root causes of the problem. If we give solidarity without correcting the root causes, we set incentives in the wrong way, some say perverse incentives, or another way of saying it is we create moral hazard; we set incentive to bad behavior; we encourage free riding. And that will actually just make the underlying problems worse rather than solving them. It will be throwing good money after the bad, and it would deteriorate the fiscal position of those countries in Europe that still have a reasonable fiscal position. And again, that would make the whole problem worse. So there's kind of a line of development between very sound economic principles that we'd like to observe and the solidarity that we need to practice in a crisis, and then at the end, how do we come out of the crisis? And I'll try to describe that line to you.

If you could go to slide two, please.

Now, this is just to show you the relative size of our economies. The economy of the European Union is actually larger than that of the United States. The eurozone is just slightly smaller. And I asked whether it's OK to be a little bit irreverent. The eurozone is in pretty good shape – I'll show you some more numbers later – but the eurozone has a balanced current account, which means we export and import about the same amounts. You know what the situation of the United States is. Our external debt is modest, which means the people that we owe money to are usually inside the eurozone rather than out. You all know what the situation of the United States is. And our fiscal position, our public budgets, are in better shape than yours, and we'll see the numbers later.

Now I'd like to talk about where the crisis came from. And if we go to the next slide, please. This shows the yield on eurozone government bonds, 10-year bonds, in the period leading up to European monetary union. And then through monetary union and through the crisis. And we kind of had some stages of – from '95 to 2000, that was, roughly speaking, the stage where we prepared for monetary union, where we laid down the criteria and people got ready and people said, yeah, I want to join. And what you see here is that the interest that countries that were going to join the eurozone converged down to the year 2000 – or actually 1999 is when the euro was introduced, but starting in 2000, they were almost symmetrical or parallel or the same. And that means before, people – the markets, people who lend money to Greece, Spain, Ireland and so on – they differentiated the risk represented by those countries. They differentiated the risk to them that those countries would pay back the money that they lent them. But when European monetary union came around, the markets, in all their wisdom, decided there is absolutely no difference; everybody has the same good credit as Germany, in this case. And then came the – 2007, 2008, came the crisis, and the yields changed again.

And we can go to the next slide. This is just another way to look at it. The first was interest rates that countries had to pay. These are the spreads. This is the difference over the German interest rates. Germany traditionally is considered a very safe bet for government bonds. Our credit is good, just like that of the United States. And so you can – you can see that.

And when the euro was founded in – what did I say, 1999 – and in 2002 we introduced coins and notes, everybody was aware that it's not what's called an optimum currency area. It's not the greatest place to introduce a European – a common currency. Why did we do it anyway? Because 1989, 1990, we had a revolution. The Iron Curtain came down. The Berlin Wall came down. German unity happened. And the euro was a strategic response, a political strategic response, to German unity.

Some historians say, and it's probably true, that all our neighbors had some slight worries and said – in history, there's something called the German question, which means what does it mean for Europe that in the middle there's this relative big bloc of German-speaking people who, in 1870, became one nation, and then they were so big with so many neighbors and then they – for the 20th century, they caused a lot of trouble, and there was World War I and World War II, and they tried to conquer the world and they committed the Holocaust. And so the German question is really, Germany is a big bloc in the middle of Europe with neighbors that are all smaller. Germany actually has nine neighbors. I think only Russia has more, or also nine. And then German unity came along, said, oh, my God, look, what does this mean for the European Union; this Germany is going to be big and powerful right in the middle. And the strategic response was, let's deepen our integration, because European integration was always – also a way to make Germany productive, but prevent it from being too powerful. So let's deepen our integration; let's have monetary union.

And it was – some people have written, it was a quick and dirty way to have just the monetary union, although we knew we're not an optimum currency area. If – an optimum currency area means it's an area that will definitely benefit from introducing a single currency and that can react to economic shocks even without, how you say, the escape valve of exchange rate adjustment, so that within an area, if you have divergent economic trends, if you have different currencies, one way that you can adjust is that the – your price level will adjust via your currency exchange rate. So all that was not given when the euro was founded. But we were aware of that. But nevertheless, the markets treated us as if we were perfect.

And we can go to slide three, please. And the fact that the interest rate was so low meant that those countries and every financial market participant in those countries could borrow money at a very low rate. Money was cheap. So cheap money was abundantly available to all the countries. But what did the countries do with it? Now, these are unit labor costs in eurozone countries. Unit labor costs are a – one indicator, quite a good indicator, of competitiveness of economies. Unit labor costs measure what is the price of one unit of labor for one unit of economic output, in other words, an hour of work for a dollar of GDP. And they tell us something about, well, how are they – how countries compare in terms of competitiveness. And what you see here is since the euro came around, German labor costs were very low – actually went down for a while because we did some tough reforms in the – in the middle of 2005, 2006, and they went up quite strongly in all those other countries. And look at Greece. So what did those people do with the cheap money? They consumed on credit. They didn't invest it productively. So if you – if you – it's good to get a loan, it's good to invest it, but if you invest it into something that won't produce a return for you, you might have a problem at the end repaying your loan.

And that's exactly what happened in the – let's call it the peripheral countries. Wages went up enormously in Greece. The Greek minimum wage is 20 percent higher than the Spanish minimum wage, but their productivity is lower. It's about 60 percent higher than in Estonia. They – and they've – people lived well, they consumed, they went to the restaurants, took holidays and so on. There was a real estate boom in many of these countries, Ireland and Spain in particular. And banks expanded their balance sheets.

So these countries lost competitiveness, and they couldn't resort to the exchange rate to regain competitiveness. They're – the price of their goods and services went up, but they didn't have the escape valve of exchange rate adjustment. At the same time, something similar was happening in the United States. You also had cheap money, and you also burned it on consumption. You invested into a nonsustainable bubble called subprime market, financed by asset-backed securities. There was failed regulation, failed supervision and, many would argue, a failed monetary policy. And in 2007, the Lehman crisis hit first you and then us. And I think – I'll just interject this – if there's one lesson from the financial crisis, it's that the belief that markets are always right and will always regulate themselves because they're not going to commit suicide is disproven.

And we could go to the next slide, please. And so then what happened when the financial crisis hit us? You know, what I'm going – what I want to talk about here is the link between the private financial sector and the public financial sector, the link between banks, private and public sovereigns. When the – I'm not going to go through the whole financial crisis, but there was, like, a credit freeze, there was no demand in the economy, and what you could do is to have a Keynesian type of stimulus – in other words, government borrows money and injects it into the economy to create demand and to break out of a downward cycle. And so you see here, this is the debt-to-GDP ratio of selected countries. And you see 2007, it was quite low. And then because of this crisis emanating from the United States, everyone's jumped up, in particular, the United States. In these projections of the IMF, you have a long-term problem. The eurozone is doing better than you, and Germany is certainly doing better in you – than you.

We could go – let me just see. No, let's stay here for a moment. And then you have this link between private sector finance and public sector finance. Some people call it a doom loop. That's too much bad debt in the system. Creditors don't trust the debtors, so they ask them for higher interest, more collateral on the debt, that makes the financial situation of the debtors worse. The creditors become even more suspicious of them. There's a downward spiral or negative feedback channels, and there's the risk of contagion between the private sector and the public sector. And there's a risk of contagion between different public sectors.

And we could go to the next slide, please. This shows the budget deficits. It's related to the previous slide. So again, coming from the financial crisis, we all had to do big public spending to save our economy from really – from going even more off a cliff than it did. And now we're trying to climb back. Zero is a balanced budget, so we're all – we all have budget deficits. And again, it's IMF projections. Germany is in a much better position. And the eurozone as a whole is in a better position than the United States. But what this – what these two slides also show that in the crisis 2007, 2008, we kind of shot our ammunition. Our fiscal position is poor, and we're – the economy is fragile globally, but we don't have, really, a lot of – people say – call it fiscal space. We don't have a lot of money that we can throw at the problem. And I'm going to leave that up there for you to contemplate for a while.

So back to the euro. There's three kinds of challenges. One, we need to clean up the financial markets. Then we – and that's a financial challenge. The economic challenge, we need to find a way to support growth. And there's a political challenge: We need to strengthen the cohesion of the eurozone and thereby make sure it brings the contribution that it should bring to the global economy.

And the policy responses for those three types of challenges – I'll describe them briefly. The financial crisis situation, there we talk – that's the short term – we talk about firewalls. And we've created in the European Union two kind of instruments similar to the IMF – I like to think of them as IMFs for the eurozone – where governments pool resources to help other governments or banks that are having a liquidity problem. One is called the European Financial Stability Facility, and the one that is being set up right now is called European Stability Mechanism. It's basically like an IMF for the eurozone.

In the medium term, we're working on financial market regulation because of all these financial market problems with the supervision, regulation, resolution of failing banks is insufficient. We're working on that. I won't go into that much today. And in the medium to long term – and this is the key point that the German government keeps emphasizing – we need to regain competitiveness and sound public finances. And we're working on all those fronts at the same time. Those are the different elements that I mentioned before.

And we – with the U.S. government, we have some differences of opinion. We have some differences of opinion what should be prioritized, which instruments which should be used, what the speed and the volume of measures should be. And those are differences of opinion that are, how do you say, discussed in a very friendly and respectful way, because we're old allies and partners. It really is that way. And – but generally speaking, the U.S.A. said, you should have a bigger firewall to save – to bail out your neighbors, and you should do more – you should do more for growth; you should have more growth-oriented policies; you should be doing more deficit spending, making more Keynesian impulses to raise demand, and you should move more quickly to reform the way you operate in the eurozone – in other words, you should move more quickly towards the mutualization of risk. Part of that discussion is, for example, a pan-European deposit insurance. And you should more quickly to the mutualization of debt. That discussion is the – the key word is eurobonds – that all eurozone governments issue debt jointly and they share the liability for that. In other words, those with a good fiscal balance should share their good credit with those that are poor.

The Americans are basically telling us, you should do what we did: deploy overwhelming financial force; shock the markets into submissions. And it brings me back to the first picture. That leads to the mistaken assumption that Germany could just do that, yeah, just do it, deploy overwhelming financial force. And we – there's – the U.S. government, of course, has a self-interest in all this, which is legitimate, because our influence – our economy influences yours. And you've got an election coming up, and the economy is the key issue, so that heightens the attention.

Now I'll repeat what the view of the German government is to this criticism that none of this overwhelming financial force will work if we don't address the root causes of the problems. And those root causes are unsustainable public finances and the loss of competitiveness. So we need to return to sustainable budgets in the public sphere and we need to return to competitiveness in the economic sphere. And everything we do, we need to strike the right balance between emergency measures and setting the right incentives; and sequencing is important.

And our point of departure, our point of departure was a simple economic prescription, if you like, and that's that sound public finances and low inflation are the basis of long-term stable growth. Sound public finances and low inflation are the basis of long-term stable growth – sound public finances because public finances are the basis of the interest-rate pyramid. If you have sound public finances, everyone in the country, all market participants will be able to finance themselves at reasonable rates and they don't have to fear tax hikes to balance the budget at some point. So if you don't have sound public finances, you will have distortions and misallocations in the economy in the long term.

And inflation – you should have low inflation, because inflation distributes wealth from people holding monetary assets, so people have gone through the trouble of saving, to those who don't have monetary assets, in particular those that have debt. So it incentivizes unproductive economic behavior. And it's a political issue, too, because it's unjust. If it happens through inflation, there's been no democratic decision to transfer that wealth from one group to the other. But if you're going to transfer wealth in a society, you should have a democratic decision.

And because we believe in sound public finances and low inflation, we had the Stability and Growth Pact, the Maastricht criteria – I think I'm probably well over my time – but we enshrined, when we founded the euro, some principles. For example, if you wanted to join the euro and stay in the euro, your budget deficit could be no more than 3 percent of GDP. Your debt-to-GDP ratio could be no more than 60 percent, and you had to have a low inflation.

In the treaty of the EMU, there is the no bailout clause. It is forbidden to take over the debt of another eurozone member state by law. And that's again – it's this very simple principle that's very important. It's the example of a family and one guy overspending and overspending. But if you have – our hope was if we have a clear law and you said, if you overspend, you are out and you on your own – it is forbidden for us to help you. So you had a strong incentive to behave financially properly, but it didn't really work out. We didn't enforce our own laws. And we have an independent central bank that is also by law forbidden from taking over the debts of states.

And where we are now is really in between a rock and a hard place. We want to stick as much as possible to the good economic principles that I mentioned, because they remain right. Nevertheless, we are in a financial crisis, and we have to provide solidarity, because what good will all our principles do us if our whole system blows up and banks go bankrupt and businesses go bankrupt and there's a vicious downward spiral into a depression? Then it's no point in going – (inaudible) – while we have the right principles.

So what we want to do, as Germany, we'd like – so the economic principles we say, that's solidity, and helping out the others is solidarity. And we would like to have as much solidity as possible and as much solidarity as necessary.

I have a bunch of details here on the firewalls that we've set up. Maybe I should just say that the ESN firewall, that's to help out – to bail others out in the eurozone, the German contribution to that is 54 percent of our 2012 annual budget. So, it's huge. So the notion, can't you just turn on the motor Mrs. Merkel – we've already committed 54 percent of an annual budget to bailing out others in the eurozone.

And you know, we could go into the final two slides. Oh, this is – this shows the size of the European – the eurozone economies in relation to each other: 27.2 percent is Germany in the purple, then France 21 (percent), Italy, Spain, Netherlands. And then it gets really small. And 2.5 percent is Greece.

You can go to the next one, please. Same picture, different showing in the next one. So this has to do with the relationship between the core and the periphery in the eurozone. The core are Germany and France, and there are other core countries in Central Europe with good fiscal position, and the peripheral countries are the ones that have programs already. Greece, Portugal and Ireland are the first three that – (inaudible) – just now joined. We could basically pay those from our (coffee ?) money budget. But if the crisis spreads to Italy and Spain, then we'd have a problem because then all we have is the core left paying for everybody else, and that's the key issue. But the political issue is, the periphery is more dependent on the core than the core is on the periphery. And economically, the core drives the eurozone, not the periphery.

And if we could go to the next slide, please.

This shows the – this shows the central bank balance sheets. Green is the Fed. You see in the crisis, you started combining all these securities and it going up. Bank of England, even more extreme. ECB did some things but not so extreme.

And if you could show the next one, please. This is the same thing. This is the asset holdings – ECB, European Central Bank, on the left, Bank of England on the middle, and the Fed. These slides are supposed to show you that the European Central Bank still has some firepower left. People always say to the German position: That's all good and fine. You're insisting on economic principles, but the house is on fire and you're reading a list of principles. Why don't you send in the fire engine?

And we say, we are ready to send in the fire engine, but we have a big fire engine. The house is not really totally on fire yet. So before the house goes on fire, it doesn't – goes completely on fire, it doesn't make sense to send in all the fire engine(s). And we have a fire engine in the background that will help us to buy time for the process that we need to do to travel on this timeline between solidity, good economic principles, travel along, make our way through the crisis and using elements of solidarity. And at the end, we come out with a different eurozone where there are – might be a different way. We manage our business, we change our governance. We're in the middle of doing that. And there might be a completely different way. We might – we might move a big step or completely in the direction of an optimum currency area; at the end of the process, could be the mutualization of risk and that the so-called eurobonds. There's a lot of ways to, I think as Americans say, to skin that cat? Yeah? (Laughter.)

And it doesn't – the process – and I'll conclude. The process has to be – I wrote this one down – the process has to be synchronized and proportional to make sense. And we think it is still better to go in a gradualist and incremental approach, and we think we have the time and the resources to manage that, but we will also adapt as we go along, and we have resources even for the worst-case scenario, but let's not assume that. And we didn't talk about Britain at all. Britain has opted out of the eurozone. We want Britain very much to be part of Europe because historically and culturally they are, and they give us such great leaders like Churchill, who gave us a lot of great quotes. And I think one of them applies very nicely to the eurozone crisis, "If you're going through hell, keep going." (Laughter.)

Thank you. I'm sorry I spoke too long. (Applause.)

MR. BENNETT: We have time, and encourage questions. So any questions for Peter?

Yes, sir.

Q: Someone once said that – someone once said that the problems in Europe are really social problems between countries that nap during the day and countries that don't. And given the fact that – you talk about political and economic problems, but all politics flows from social issues. And you have an election coming up between now and 2013. Can you speak candidly about how that social dichotomy in your upcoming election affects that sinking-boat?

MR. FISCHER: You mean the social situation in Germany?

Q: No, the social situation between countries that nap and the ones that don't.

MR. FISCHER: Yeah. Of course –

Q: The ones I think you – what was the phrase you used – peripheral.

MR. FISCHER: The peripheral countries, yeah. That's not meant in the derogatory sense. They just happened to be at the – at the edge of Europe. Yeah, of course, that's part of this issue, that we weren't really mature to be a single-currency area because we've had very different structures of the economy that were based on different structures in society, that are based on different cultural traditions and attitudes. And so on this pathway that we're traveling, we will have to, how do you say, align our economic way of doing things more and more.

And that's a – one of the fundamental commitments that members of the EU and the eurozone engage in when they start. They say we are – we want to integrate and align. We have a single market, we pass regulation on our standards for our products, on our labor markets and so on. A lot of it from – and more and more of it comes from Brussels as European regulation. So that's part of the process that we're traveling on. It's your – I agree with you that a lot of the problem comes from this nonalignment. There doesn't have to be total alignment.

Q: And naps?

MR. FISCHER: Pardon?

Q: (Inaudible) – naps are OK, or no?

MR. FISCHER: But if you go – if you go to Madrid nowadays, hardly anybody naps anymore. It's very depressing for us Germans. We go there and we look forward to having a nap. And then they say, no, we don't do it anymore. (Laughter.) But you know, someone once said, to really solve the problem what you're expecting is for the Greeks to behave financially like the Germans, and ain't going to happen. But it has to happen – there has to – there has to be kind of a bandwidth in the middle that we have to agree on.

And one of the things about Europe is we celebrate our diversity and our common links. But in the economic and social sphere, it is a decision that we make – even with a single market, even regardless of the common currency – is that we have to give up some our particularities to gain a greater benefit, a bigger market, freedom of movement of people, of capital, of goods and services. And sometimes when I speak to people that are younger than you, I say, you know, you should know that Europe is still the greatest place to live. That's why I introduced the two young people a little bit.

If you're a citizen of Germany or of Britain or of Spain you can pick up today, you can move to another EU country. You don't need a visa; you don't need a permit. You can – your educational qualifications will, in 99 percent of the cases, be recognized. You can transfer all your capital. You don't have to pay any tax or customs on it. And young people today, you know, they take a budget flight from Warsaw to Milan to go clubbing or Sheffield to Avignon, France. So – yeah, more alignment will be necessary.

MR. BENNETT: (Inaudible.)

Q: So you talked at length about the need to balance stability against solidarity. I would argue there's a third S-word that – building on the gentleman's question – sovereignty.

MR. FISCHER: Yeah.

Q: So obviously a big decision regarding moving to funnel capital directly to financial institutions, to adopt a growth package and further mesh, I think, a lot of the risk between the countries together two weeks ago, what are the expectations regarding individual countries' sovereignty moving forward?

MR. FISCHER: Yeah. That's a very good question. And you're exactly right; that's the key question in this whole process, in this line that we're traveling. To form a better monetary union we must give up some sovereignty. And we must give up – people say the most noble sovereignty that a sovereign has, fiscal sovereignty, budget sovereignty – no taxation without representation. It's – you know, it's a fundamental democratic principle that a parliament for a particular constituency has to be legitimate to decide on the fiscal issues, on the taxation and how the money is used.

And now, again, the underlying assumption of the European Union is that we pool our sovereignty and we gain something better from it. You know, because we're all small countries and we think in a larger area we will have advantages. But the – traveling that line, the sovereignty issue becomes complicated. Some are more ready to transfer sovereignty. I would say in the current political conditions Germany is quite ready. And that comes back to our history in the second world war. We didn't have any sovereignty. We were grateful that we could join other countries and pool our sovereignty. We've been traditionally more integrationist. I don't want to speak for France, but it's not a secret that they're a proud nation and that their last and present government are not so keen to give up sovereignty. They would like the member states to hold on to more power.

And of course, under what conditions do you transfer sovereignty? That's – you know, we say we will pool our fiscal sovereignty more and more, provided there's also an element of pooled control and that the principles are right. You know, if we say we're going to pool your sovereignty so we can all have five hour naps and drink wine and blow somebody else's money – no. Pool your sovereignty in a – in a – in a cohesive, well-organized monetary union? Yes, from us.

The Finns, for example, and every country's sovereign – every country – Slovenia, Slovakia, Finland, Netherlands, Belgium, and all the others; they all have this sovereignty issue to discuss with their constituents and they need to get majorities. But again, the underlying assumption has been giving up sovereignty. So we're used to it, in a way. We have done so in some aspects. But fiscal sovereignty is a huge jump. And my prediction is that we will take it, but it's not easy. That's why it's such a messy long-term thing.

Q: So do you – I'm sorry, just to follow-up then. Do you anticipate that there will be a package of reforms or new requirements that will be debated over the next six to 12 months, kind of to balance out what was agreed to two weeks ago, or is that just – is it a longer-term –

MR. FISCHER: No, it's – I mean, it's an ongoing process. The political – one of the key ways to look at it is that there's two timelines – the political timeline, which is by definition a bit of a slower timeline, and then the timeline that the markets dictate, which has been accelerating and can accelerate quite quickly. So it'll play out in the balance of those two timelines, but we've committed to pushing ahead some key elements very quickly – very quickly. And we've started already to the last – the 28th and 29th of June, there was a European council. And one of the elements of the Growth Compact are so-called project bonds, which is a little, tiny euro bond. So we're on that path.

MR. BENNETT: Before we get to the gentleman in the back, let me take the moderator's privilege and ask a question. One thing that folks here have to worry about is if, as you just noted, things get bad very quickly. If there's a speculative attack on Spanish or Italian bonds, is there enough flexibility in the system and enough water the fire department has to manage a very fast and very big crisis?

MR. FISCHER: Yes. (Laughter.) I was tempted to say I think so or I hope so, but I have to say yes because there is the ESM, which has a 500 billion euro firepower, plus about 250 that are left over from the previous mechanism, plus another hundred from community – European community funds, plus the IMF, plus the ECB. Now, the ECB is still legally prohibited from buying government bonds in order to relieve their debt, but they have had a securities market program where they have purchased. And they've defined that as supporting monetary stability in the currency zone. So from the – from the principles of the European Growth and Stability pact which I mentioned – from the no-bailout clause to where we are today, we've already moved heaven and earth basically; our principles are hard to recognize.

MR. BENNETT: I think we have time for two more questions. There's one in the back and then we'll go this way.

Q: Thank you for being here. Isn't there a strong self-interest to accelerating the timelines that you discussed? I understand the political timeline is going to be the political timeline, but you mentioned the market timeline. The markets seem to be really bullying the policymakers.

After every – you know, even after this most recent summit, the yields on Italian and Spanish debt still hovered around seven, which is obviously problematic for them. You know, and now you have people talking about, you know, Silvio Berlusconi, he's going to run for prime minister again on the threat of leaving the eurozone.

So isn't there – I guess my question is, are there any German policymakers or business leaders making the argument that it's necessary for us to accelerate our integration in order to remove the threat of a eurozone exit, which would be disastrous to our exporters, to our eurozone trading partners? Thank you.

MR. FISCHER: It's a point well-taken. Yes, there are politicians and business leaders and financial people who say advance more quickly into the new sphere of mutualization, because that's really the thing that would impress the markets, supposedly – let's hope so if we go that way. But it's – the majority consensus opinion is still if we head in that directly too quickly, we might be creating moral hazard.

If we – if we say, yes – there's many different schemes out there for mutualization of debt, different kinds of euro bonds – and it's all partial; it's not all the debt at the same time. But if we adopt any one of those schemes, will that, how do you say, strengthen the reform will of an Italian government after the present one, maybe led my Mr. Berlusconi, or will it weaken it?

And our position is still we need to do whatever it takes to make sure that the reform will stay strong. They need to reform their labor markets, their product markets. They need to make their public service a lot more efficient. They need to collect the tax. That's the case in Italy. Certainly in Greece the – they just don't collect the tax that is due to them. If they did that that would already be big contribution, but the system just isn't working well.

So we have – in Germany, we have the whole bandwidth of opinions too. But our government's opinion is the one that I formulated, and the majority of the population likes it. Mrs. Merkel is getting still very high approvals ratings, especially for her eurozone conduct.

MR. BENNETT: A follow-up question – (inaudible).

Q: Are the problems – the financial problems that Europe faces, is it because of a failure of the market or a failure of government?

MR. FISCHER: Both. Yeah, the financial markets, as I said, were not – they were stupid. You know, they – I mean, they ran part of their business against the wall. The problem is the financial markets always – someone's losing money, someone on the other side is gaining it. But it can be not very productive for society. So they didn't work well. The governments didn't supervise them well. And of course, the public finance is a result of governments overspending, not being willing to take the tough decisions and to sell those to their populations. This is an issue that you probably have heard around – that you probably have heard about before in these very premises.

MR. BENNETT: We need to leave it at that. Will you join me in thanking Peter Fischer? (Applause.)

(END)