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"Let Us Not Waste the Crisis!"

Imagine that your energy provider installed a new supply system that gave you excellent profits but also a power failure every four weeks. Imagine that farmers got rich on a new cultivation method that resulted in a failed harvest every seven years. Imagine the water works made potable water particularly tasty but then as a result of this innovation suddenly no water comes out of the taps.

Imagine that in these three cases the situation was both foreseeable and predicted.

Then you would inevitably ask: Is it not the task of the democratic state to protect its citizens? And wouldn't the government have to do everything in its power to ensure that a branch of business never again increases its profit and growth hand-in-hand with the risk of many others having to suffer as a result? The answer can only be "Yes!"

The 9th Munich Economic Summit addresses "The financial crisis: The way forward". We will be able to find this way forward only if we think well beyond the current crisis. We must not let the crisis go to waste, but instead learn from it. It has raised some very fundamental questions. I think three responses to it are called for.

First, we need to have the financial markets submit to the primacy of democratic politics and act at the service of the overall economy. Second, we need an economy that is at the service of the entire society. And third, we need a social cohesion that everyone contributes to. Such tasks require courage on the part of politicians, the understanding of the citizenry and the willingness to self-determination.

With its so-called financial innovations, the international financial industry drove its profits to dizzying heights with total disregard for risk. In the process it triggered a crisis that without governments' bailout measures would have led to the collapse of the global financial system. Governments, parliaments and central banks had no choice

but to respond with unprecedented financial stimulus packages and comprehensive guarantees for financial institutions. They had to accept an explosion of public debt and the resulting liability for taxpayers, today and in the future.

A bailout of this sort cannot be repeated – neither financially nor politically. Isn't it imperative that the democracies of the world do everything in their power to avoid a repetition of such a crisis? The answer can only be "Yes!" Citizens all over the world want to be protected from irresponsible activities in the financial markets. The next serious crisis of the financial system would not only question the viability of our economic and social model but also its credibility. It is thus imperative for democracies – as communities of values and protection – and their political representatives to counteract this threat.

The summit conference of the heads of the G-20 states in Pittsburgh has laid the proper foundation. The international financial industry and its lobbyists will leave nothing undone in their efforts to water down the agreed measures. At the same time the betting continues, new financial bubbles are developing, and while the countries and their citizens continue to fight the consequences of the crisis, the financial institutions have once again approved gigantic bonuses for their employees. Have the people concerned understood what is at stake?

It is clear that the practices of today's prevailing financial capitalism cannot be a model for us. It operates primarily with bets and debts. It boosts its profits without considering whether it benefits the well-being of nations. The pattern of the present crisis, where a few pocket the profits while the public bears the losses, is simply not acceptable.

There is a better model. Twenty-five years ago Ralf Dahrendorf referred to it when he distinguished between capitalism oriented towards borrowing and capitalism oriented towards saving. The latter implies the creation of enduring values instead of betting, the financing of real goods and services instead of building virtual financial pyramids. Savings-oriented capitalism is dominated by real economic investment and property and it encourages responsibility, not short-term thinking and speculation. It focuses on a stable monetary value and respects those who save to provide for the future. An economy based on this model improves the living conditions for everyone. It aims at sustainable prosperity for everyone.

The role of the financial markets is to serve an economy that follows this model. They should act as a trustworthy mediator between those who save and those who invest, instead of jeopardising everything. This serving role is their justification for existence, and holding them to this role must be the central goal of a reordering of the financial markets.

Politics has to regain its primacy over the financial markets. Financial market actors were given too much unregulated leeway. That was one reason the financial crisis arose. The state was then in a position to be blackmailed – and it still is. This must not happen again.

It is imperative that simple, firm rules are set for the financial industry. Clear limits must be imposed so that freedom does not destroy itself. Four consequences resulting from the crisis are of prime importance:

First: The core free-market principle of liability must once again have universal validity, especially by requiring financial institutions, regardless of what they call themselves, to hold sufficiently high equity buffers; this would entail including, for example, hedge funds and private-equity firms.

Second, and this is closely connected to liability: No bank or financial actor should be allowed to become too large to fail. This will require special insolvency rules for internationally operating financial institutions, including the possibility of subjecting them to a temporary state-administered receivership.

Third: We need the greatest possible transparency for the so-called derivatives and an end to shadow banking. An international procedure for obtaining permission for financial innovation should be set up, and derivatives should only be allowed to be traded on public exchanges.

Fourth: The G-20 government heads should insist on the financial industry paying a “fair and substantial contribution”, as was stated in Pittsburgh, to help cover the costs incurred by the crisis. I personally think that a tax on international financial transactions would be the best way of doing this.

The German federal government is planning the right steps – this can be seen in the key points they have agreed upon for a new regulation of the financial markets. It is also good that there has been close co-operation with our French partners. I would like to see the German-French partnership show even greater leadership. Because as

necessary as it is to have a new global financial order, in political terms we are still far from establishing one. Shall we just continue to wait? President Obama gave a strong impulse to the American debate in his speech on financial reform and I wish him success. He rightly said, "...a free market was never meant to be a free license to take whatever you can get, however you can get it." But even if the reform in the US moves forward, Europe should not assume a wait-and-see attitude. I think that the Euro group would do well to present its own, strong suggestions for a new set of rules. It should not be afraid to simply forbid some financial instruments, such as naked short selling or highly leveraged over-the-counter transactions. For this type of "weapons of mass destruction" we also need disarmament. And Europe needs an efficient, central supervisory agency that watches over cross-border institutions, and a European rating agency. This would be consistent with our commitment to a stable euro.

Today I only want to say the following about the euro and the situation in Greece: the euro has so far performed well for Europe. If we do not make serious mistakes it will continue to do so and be an anchor of stability in the world's currency system. It would only distract us if we once again take up the battles of yesterday. Greece must now accept its responsibility. But it also, understandably, expects assistance to help itself. The participation of the International Monetary Fund is to be welcomed because that way we can tap the experience this institution has with handling debt crises. It is also in Germany's own interest to make its contribution to stabilisation. And all the members of the Euro group and the European Commission have to learn from the crisis. The European Economic and Monetary Union needs to co-ordinate the national economic and financial policies and to put in place an effective mechanism to counteract unfavourable developments in member states in a timely and sustainable manner. The federal government is right in working towards these goals.

Even if the European Union and other countries were to provide a proper regulatory framework, this alone would not suffice. Paraphrasing a famous saying of Ernst-Wolfgang Böckenförde: Also the free-market economy lives from preconditions that the state cannot guarantee. It counts on economic actors following not only the letter of the law but also its spirit, orienting their behaviour towards values and attitudes that the state cannot simply impose. In business, for example, these would be the values and attitudes of an honourable businessman. The more managers that take this role model to heart, the freer the market can be.

If freedom, good rules, creative diligence and integrity come together, then sustainable economic success and social cohesion can develop. That is our experience after 60 years of a social market economy.

That is why on our path out of the crisis the following question is important: How do we maintain the strength of the market economy? I think that every country first has to look at its debit and credit balance. Let's look first at public debt.

To prevent the world economy from collapsing, the industrialised countries have increased their public debt dramatically – within three years by 20 to 30 percent of their GDP. The OECD expects the debt of the industrial countries to surpass their national income – ie 100 percent of GDP – next year.

This has consequences. New research shows that public debt levels considerably lower than the present ones mortgage the development of the economy and society. Historically, financial crises have primarily been debt crises. This is also true for the present crisis. The bitter truth is that, even long before this crisis, most Western societies have been living beyond their means.

And Germany is not an exception. Our explicit debt is almost EUR 1.8 trillion or around 74 percent of our entire GDP. If we include the implicit debt, that is all financial promises that the government has made for the future, such as the financing of social security benefits and pensions, the entire debt is considerable higher.

Up to now we have assumed that economic growth will help to take care of the debt problem. Some experts even recommend that we go more deeply into debt. I think that is not good advice to follow. It would lead us into a hopeless situation because for the developed economies the limits to growth can no longer be ignored.

Germany's potential growth– as well as that of most other industrial countries – has continuously declined in the last few decades. It is now around one percent. A slightly better growth scenario for Germany is still possible, and desirable, for a while. Success will depend on our strength to carry out structural reforms. But I am just as convinced that we cannot rely on growth and growth policy alone to solve the debt problem. We must also take into consideration the rapid decline in population. In 2050 Germany will probably have 10 million fewer inhabitants. Fewer and fewer people will have to service the growing mountain of debt if the situation stays the way it is now. These prospects for the future of Germany are not good. And I can only warn against seeking "a

solution" to the debt problem in "controlled inflation". To the contrary: there is not doubt that the central banks are committed to reining in the current excess of monetary liquidity in the markets – one of the main causes for the present crisis.

My advice for Germany is as follows: to secure long-term stability and reinvigorate our social market economy it is imperative that consolidation of the public budget be the most important and decisive task of the government for the next ten years. This is not only a constitutional obligation, but a moral one as well. Consolidation will only be successful if the government's expenditures and subsidies are lowered.

I suggest that the mending of public budgets be connected with an effective reform of our tax and transfer systems. These mutually additive systems are full of inconsistencies, and due to their complexity it is extremely difficult to determine whether they even achieve their political goals. I think that just by simplifying them and removing their inconsistencies a great deal can be achieved. I also plead for a savings policy that clearly states where savings are not appropriate.

We should not save in the spheres of education, research and innovation. We need to invest more, not less in our educational system, in our universities and research institutes and in a social climate in which education and endeavours to achieve an education are respected. A concerted effort to achieve these goals is the most important contribution to the future development of our country.

Good education for everyone is the pre-requisite for social integration and for high-grade jobs. It is at the same time the most important response to the question of social equality. Children from immigrant families, children from low-income families and low-education backgrounds face poorer educational opportunities than their peers. That is an outrageous injustice that has a devastating impact on our economy and social existence. Also our vocational education, universities and research institutes urgently require greater investment.

The agreement between the federal government and the federal states to increase expenditure on education and research gradually to ten percent of GDP by 2015 is a step in the right direction. This intention must however be implemented into reality. Achieving this goal is worth a tax hike if necessary.

World-class educational systems and research institutions are necessary for the conversion to an ecological social market economy. We have no alternative. In 1800 a billion people lived on the earth, in 2000 there were more than 6 billion and in forty

years there will be over 9 billion. But the raw materials and biosphere cannot grow in line with these numbers. Thus the world needs a third revolution – after the steam engine and the microchip – a revolution in environmental sustainability, a revolution in the economical use of resources and the progressive development of renewable energies. This revolution has already begun, and Germany is a leader in the field. But we cannot rest on our laurels.

I advocate that we set systematic and comprehensive goals for a future-oriented policy of transformation. This means that we will have to accept far-reaching changes in the economy and our life style. But it will be change that we ourselves shape – not change we have to suffer. And it will be worth it: experts tell me, for example, that today we could reduce the use of resources in Germany by 30 to 40 percent if we are more efficient. I am convinced that the “green revolution” will secure not only jobs and income for the future but it will also improve our quality of life.

I would like to encourage economists to think more about how the market pricing mechanism can be used for a future-oriented ecological transformation policy. I believe, for instance, that the ecotax deserves more self-confident political advocates – as numerous studies show.

Achieving more with limited resources also applies to our welfare state in general. We should view it from the perspective of its goal – from the individual. It is essential to invest in the individual's abilities, to foster and promote his strength of self-determination and self-provision. I call that the “investing” welfare state. You, Prof. Sinn, speak of “activating” welfare state. We mean the same and we have, I believe, a very similar view of human beings – we believe in the individual taking responsibility for himself. Agenda 2010 was a step in the right direction. We have not yet reached our goal.

To ensure that our welfare state is well-prepared for the 21st century we have to ascertain whether it is investing sufficiently in fostering the responsibility and autonomy of its citizens. Only then can it achieve what it aims to without continuously expanding – and it must also become more efficient in view of the dramatic demographic change in our country. The expenditure in social transfers is very high in Germany – around 750 billion euros yearly, almost one-third of GDP. But we often achieve considerably less than other countries. In some cases we don't even know what we are achieving. One example: almost 190 billion euros are spent on promoting marriages and families. How much of that actually encourages people to start a family, how

much of that actually provides children with a good future, no one can really say. At least this question is now being properly investigated.

The best social security is help to self-help, the best social movement is upwards mobility through self-achievement, and what tastes best is self-earned bread. This is why we should demand from our social welfare state that everyone who wants to work must be able to and earn enough from it to live on. These tenets can be realized when we consider that in Germany we are facing a paradigm shift. In just a few years demographic development will lead to a shortage in highly qualified workers. Businesses are responding already with their efforts to keep skilled workers despite declining orders. That is positive, but we can still do more.

Above all we have to develop the market for people-oriented services, especially since demand is growing. The population is getting older and that means ever more people will need help and nursing care. And an increasing number of households will need or want both partners to work. That means that demand for childcare and household-oriented services will increase.

This indicates that we will not run out of work in Germany, and this offers a chance for all those who seek work to feel needed and appreciated. Both the Institute for the Future of Labour and the Institute for Labour Market and Vocational Research of the Federal Employment Agency have made noteworthy proposals for a future-oriented labour market policy. I agree with them that full employment is possible in Germany. Why don't we finally make this our goal? An investment-strong social welfare state and an economy that serve the entire society – these goals can be achieved!

Now, what is the third step that will enable us to leave the financial crisis behind us? What kind of society should the economy aim to benefit? I can only touch on this question here. But it is important for us to always keep it in mind. I advocate a free and fair society of citizens committed to solidarity. A society that excludes no one, helps all citizens to develop their talents and live a life that they themselves determine, and that brings people together.

It is important to recognise that such a subsidiarity society is dependent on a sound political implementation of the national framework. Small-scale groups, such as families and villages, should not have to conduct government businesses just because the government does not have the money for such activities. Rather, such groups' own responsibility has to be appreciated as a value in and of itself, one that can also serve

the common good.

This assumes a new relationship between committed citizens and the state. Where committed people take on social tasks on their own initiative, the state should not seek to take over in these areas but to support them and give them the freedom to do so while recognising and fostering their strength and ideas. I have met so many people in our country who are active in self-help groups, in sport clubs, in parent associations, in parishes and in citizen initiatives. These people are already searching for solutions to new questions; they are creating social cohesion, solidarity, a sense of belonging, and trust. In the economy, capital is often a keyword. What is created here is social capital. It is at least as valuable as financial capital.

The Financial Crisis – The Way Forward: if politics can rein in the financial markets, if we can transform our social market economy to make it ecological, if we can shape our social welfare state and strengthen social cohesion, then we will not have wasted the financial crisis. We will have used it to create something new. That is worth the sweat of our brow.