Jens Weidmann: National sovereignty and global challenges

Speech by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, at the awarding of the Karl Klasen Journalism Prize, Hamburg, 30 January 2018.

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1. Welcome

Senator
Mr Klasen
Mr Erlanger
Ladies and gentlemen

Please accept my sincere congratulations, Mr Erlanger, on being awarded the Karl Klasen Journalism Prize.

As the Chief Diplomatic Correspondent for Europe at The New York Times, you make a valuable contribution to the strengthening of transatlantic relations – something which mattered greatly to Karl Klasen.

It is an admirable, and at the same time, demanding task, explaining the workings of Europe and the European Union.

2. Damaging isolationist tendencies

Since the year 2000, the official motto of the European Union has been "United in diversity". That slogan is intended to convey the idea that Europeans work together for peace and prosperity, and that they view their cultural and linguistic differences as an asset.

In the light of recent events, a fair number of those gathered here today are probably thinking that the issue of diversity has pushed the concept of unity into the background.

Here I am thinking in particular about Brexit, which represented the first backwards step in the process of European integration. Parties criticising the euro and the European Union have enjoyed considerable electoral success in many countries, Germany included, and EU member states have shown themselves to be anything but united, not least in the dispute about the reception and redistribution of refugees.

Exacerbated isolationist tendencies haven't been confined to Europe, though. Protectionism has returned to the international economic policy agenda. Demands for a more restrictive trade policy have been voiced not only in the United States of America, but in other industrial countries too. The USA's recent imposition of punitive tariffs on producers of solar panels and washing machines is an example of rhetoric being followed by action.

Trade-restrictive measures often provoke backlashes, and these harbour the risk of erupting into trade wars in which there can only be losers. The US Solar Energy Industries Association, for instance, is expecting a net loss of 23,000 jobs in this year alone. The punitive tariffs on solar panels and components will also drive up domestic production costs, and probably depress demand for solar panels. This is turn means that fewer solar panel fitters will be required.

Avoiding conflicts like this, which hurt everyone, is the goal of free trade agreements, remember. Yet campaigns against multilateral trade agreements such as TTIP or CETA are finding support among broad sections of the population.

Varied though these individual patterns may be, they can, in many cases, be traced back to a common cause, namely that some sections of society are afraid – afraid of the economic implications of globalisation, afraid of others having unfair advantages, or afraid of losing control.

Public concerns surrounding the impact not just of globalisation but of technological progress, too, are something we need to take seriously, even if protectionism and isolationism aren't the answer to the problem.

Economists are broadly in agreement that international trade improves welfare. But open markets don't necessarily boost prosperity for everyone. Globalisation does have its losers – and lower-skilled workers in industrial countries are chief among these.

Studies show that a substantial proportion of the industrial jobs lost in the US are down to the increase in Chinese imports. However, the majority of jobs fall victim to technological advances, which ultimately have much the same effect as globalisation. And lower-paid workers, especially, find it hard to get a new job in a different sector.[1]

Viewed from a macroeconomic perspective, the industrial jobs lost in the United States are more than compensated for by job growth in other sectors. What's more, consumers are benefiting from having access to cheaper goods from China.

If a pair of jeans made in America from 100% US cotton cost half as much again as the same pair of jeans manufactured abroad, having access to imported goods obviously means that consumers can make considerable savings. That's completely aside from the fact that international trade promotes the proliferation of productive ideas and of new and improved products, propelling economic growth.

That said, someone who's just lost their job probably won't take comfort from being able to buy a cheap smartphone, though. So there's a real danger that people might begin to turn against globalisation.

But rolling out protectionist measures would remove a cornerstone of prosperity, even if they do promise to alleviate the situation in the short term. In my view, Canadian trade economist Daniel Trefler sums this up perfectly with the following comparison: "Insular policies are about as useful as a blowdryer in an igloo." It's pleasantly warm at first, but at some point the roof is going to collapse over your head.

The right course of action should be to enable people to reap the rewards of globalisation and technological progress themselves. Better schools and universities, and lifelong learning, can equip people to make more of the benefits which an ever-changing environment can offer. And flexible labour and product markets are another catalyst that can facilitate structural change without producing stubborn unemployment because new jobs are created more quickly than the old ones are lost.

I, for one, firmly believe that open markets and economic structures that are more conducive to growth boost productivity, employment and incomes. They also allow social hardship to be cushioned by a targeted tax and transfer system, just like the one we have in Germany.

This is how we can make Ludwig Erhard's promise of "Prosperity for all" a reality and tackle public fears of globalisation and technological advances.

3. Valuable multilateral cooperation

Ladies and gentlemen

International and multilateral cooperation is more essential than ever in a globalised and interconnected world. It is only through international collaboration that a number of challenges can be tackled at all. Take climate change, the fight against terrorism or the regulation of international financial markets, for example.

The financial crisis offered a vivid demonstration of how international cooperation – particularly at the G20 level – can pay off. Cooperation among the 20 most important industrial countries and emerging market countries proved to be a huge asset when tackling the crisis and addressing its causes.

One of the great achievements of the G20 is that its members withstood the temptation to resort to large-scale protectionist measures after the 2008-09 crisis in order to protect their domestic economies from the fallout of the global slump in demand. They refrained from "beggar thy neighbour" strategies which would have stimulated their national economies at the expense of other countries. The G20 countries also reiterated their commitment to open markets in principle and agreed to combat protectionism at their Hamburg summit.

The second major achievement of the G20 is that they succeeded in learning major lessons from the financial crisis by pulling together as a team. All the milestones on the path towards reforming international financial market regulations were backed by the G20 countries.

Strengthening the financial sector’s resilience would have been unthinkable if there hadn’t been political unity among the G20 countries. After all, we all know that capital is extremely mobile, and national loopholes within the G20 would blunt effective regulation.

A key component in this regard is the Basel III framework, which had already been completed in principle in 2010. However, the last remaining aspects of the reform package proved to be a major sticking point, and it was only towards the end of last year that the members of the Basel Committee were able to endorse a compromise.

That agreement now needs to be implemented quickly and in full. This of course means that the decisions will be integrated into national law not just in Europe but by all of the members of the Basel Committee, so in the United States as well. Because this is precisely the point of having the Basel standards – having as uniform a playing field as possible.

Thanks to long transition periods, institutions that now have additional capital requirements have sufficient time to build them up. There is therefore no reason to fear a credit crunch.

In fact, the opposite is the case: in a well-capitalised banking system, there is no need to be afraid of bottlenecks in lending, even if the economy does take a turn for the worst. And already Basel III has caused banks to raise their capital levels noticeably.

German banks nowadays hold far more capital, and of a much higher quality, too, than they did just a few years ago. By way of example, Germany's large institutions improved their average tier 1 capital ratio from 5.4% in 2011 to 12.7% at the end of 2016. The buffer has therefore more than doubled in size.

The death of the French celebrity chef Paul Bocuse a few days ago reminded me of a quote of his: "If an architect makes a mistake, he grows ivy to cover it. If a doctor makes a mistake, he covers it with soil. If a chef makes a mistake, he covers it with some sauce and says it is a new recipe."

Danièle Nouy, chair of the SSM Supervisory Board, once used this quote and elaborated on what Bocuse might have said about the mistakes of banks. Nouy suspects he would have said, "If banks make mistakes, they tend to cover them with taxpayers’ money." This is precisely what should happen less often thanks to the new banking regulations, which include much more than just Basel III, namely taxpayers that have to step in and bail out banks.

Germany's presidency, besides wrapping up Basel III, albeit shortly after the end of the country's tenure, also achieved progress on other fronts. For instance, a uniform framework for evaluating the financial market reforms that have already been implemented was endorsed, as were principles for boosting the resilience of the G20 economies.

Of course, these topics don't really grab the headlines. The riots surrounding the summit here in Hamburg attracted greater media attention in any case. All the same, these are valuable steps towards making the economic and financial system more crisis-proof.

4. Germany pilloried unjustly

Many people would also consider a reduction in what have been dubbed global inequalities as a step towards a more crisis-proof economic system. Again and again, these inequalities are used to justify calls for protectionist measures.

This is shown by the fact that some countries run long-term current account surpluses while others produce nothing but deficits. Thus, Germany and China have been running surpluses for a number of years, while the United States has a chronic current account deficit.

But this state of affairs tells us nothing about how the spoils of international trade are distributed.

And yet Germany in particular has been at the centre of international criticism for many years. Time and again, Germany is urged to adopt active economic policies as a way of scaling back the surplus, such as recently at a conference in Frankfurt organised jointly by the Bundesbank and the IMF.

However, Germany's surplus can be traced back to the wide variety of decisions made by domestic and foreign consumers and enterprises; it is not the outcome of mercantilist policy.

Given demographic changes, it is wholly appropriate for Germany to run current account surpluses because, put simply, there is a shrinking number of us to generate national product and proportionally there are more and more who consume it.

A current account surplus allows external assets to grow, and these can be run down at a later point in time as more and more employees retire and draw on their savings. Also, when a country reduces its debt ratio, it implicitly improves the sustainability of statutory pensions. In a manner of speaking, the state saves on behalf of the population so that the future tax burden remains bearable.

Because growth in Germany is expected to be relatively weak in the coming decades, it is right to tap more dynamic growth elsewhere. That said, a surplus of 8% of GDP, which is the level we are seeing today, cannot be put down to demographics alone. Likewise, the low oil price, which has diminished the cost of imports, and the expansionary monetary policy explain only part of the high surplus.

It is striking that, for a long time, German enterprises built up high levels of savings. This partly reflects German enterprises' investment restraint, which only gave way to a cyclical upturn last year. One way to reduce the current account surplus, then, would be to create attractive investment conditions within Germany, for instance by implementing the energy U-turn quickly and predictably, or by extending the country's digital infrastructure.

The latter might also mean spending more on public infrastructure, for which there is currently some financial leeway. It would be important, however, to ensure that investment needs are calculated precisely and covered cost-effectively.

Business investment has climbed sharply of late on the back of upbeat industrial activity, and this cyclical upswing is likely to continue in the near future. Taken in isolation, it is probable that this will ultimately have a dampening effect on the current account surplus.

Over the longer term, however, the challenge lies in tackling the ever more apparent lack of high-skilled labour effectively, as this is another factor that will dampen business investment in Germany.

By contrast, it would be wrong-headed to aim to reduce the surplus by specifically hampering the competitiveness of German enterprises, or by rolling out debt-financed public spending programmes that would temporarily continue to fuel demand in periods that already have high levels of production capacity utilisation, ie they would have a procyclical impact.

5. Strengthening the European Union

Ladies and gentlemen

International trade, then, is not a zero-sum game in which gains and losses cancel each other out. The same holds true for the European Union.

And much like I said at the start of my speech here today, perhaps not every country profits to the same degree, but everybody does profit.

A majority of voters in the United Kingdom saw things differently, however. Brexit supporters evidently saw more negatives than positives to EU membership, wagering that the United Kingdom would be able to take back national sovereignty by leaving the EU.

How far the economic fallout of this decision can be mitigated very much depends on the substance of the divorce agreement as well as the nature of future UK-EU relations.

On this topic, Steven Erlanger wrote in *The New York Times* that: "Britain is now but a modest-size ship on the global ocean."

In an era of global challenges, this longing for profound national sovereignty seems to be somewhat reactionary.

Of course, there are tasks that can be done better at the European level than the national. Conversely, there are tasks that are still more at home at the domestic level.

Looking at the resurgent debate on the future of Europe, what I feel really counts is deciding, as a first step, whether there are any additional responsibilities that would make sense to transfer to the EU. From an economic standpoint, these might include Europe-wide public assets and policy areas with cross-border externalities, in particular. The second step would then be to clarify how these joint responsibilities should be funded.

In his speech at the Sorbonne, French President Emmanuel Macron singled out a number of policy areas that he believes should be mutualised, such as defence, border security, and climate protection.

At the same time, however, the principle of subsidiarity enshrined in the EU Treaty needs to be applied more effectively. For this reason, I am delighted to see that European Commission President Jean-Claude Juncker has established a Task Force on Subsidiarity to look into which tasks could be re-delegated to member states.

One area of responsibility that will certainly not be put back into the hands of member states is monetary policy. This, incidentally, is not what the public at large wants, either.

According to the latest Eurobarometer survey, three-quarters (74%) of respondents in the euro area are in favour of the single currency, while only one in five (21%) is against the euro. In some countries, Germany included, the approval rating is higher than 80% even. The euro sees its lowest level of support in Italy, although, even there, its supporters still outnumber detractors two to one.

That said, the crisis in the euro area revealed just how fragile the architecture of monetary union is. This fragility, however, is not due to any fundamental flaw in the single currency itself. Rather, it is more the interplay between the single monetary policy on the one side and national sovereignty in matters of economic and fiscal policy on the other that makes the monetary union susceptible to crisis.

Recognising that this balancing act can be problematic for the stability of the single currency is anything but a new insight. As far back as 1970, Karl Klasen emphasised that "a single monetary policy can only be effective if the monetary effects of public finances are also subject to common control."[2]

This, incidentally, just goes to show how long the specific groundwork needed to forge a monetary union characterised by long-term stability has been under discussion.

In any case, it was clear to Klasen, who was Bundesbank President at the time, that "deeper integration in monetary policy must go hand in hand with equally deeper integration in other areas of economic policy as well as fiscal policy." Nearly five decades on, we in Europe are still debating the right path towards deeper integration.

In my opinion, it is crucial that any proposals tabled in this debate take consideration of the need to strike a balance between action and liability. After all, responsible decisions are only likely to be made if the decision-makers also have to own the economic consequences of their actions. This applies in economics just as it does in politics.

If deepening European integration is pared down to simply increasing risk sharing and mutual liability, it will do nothing to make Europe and monetary union any more stable.

As long as there is a lack of willingness to transfer decision-making and intervention powers to the European level, then only one other path to stable monetary union remains: making the individual member states more responsible for their own fiscal affairs again.

Specifically, this would mean restoring the credibility of the no-bail-out principle set out in the Maastricht Treaty and strengthening the binding force of the fiscal compact.

Ladies and gentlemen

There is one thing we should not forget when discussing the future of monetary union: from the very outset, the euro was also a political project. This, incidentally, is a point that Karl Klasen made in the article I cited earlier.

Bearing this in mind, there can be no question that political factors feature prominently in the discussion on deepening monetary union. Incentives to pursue stability-oriented policy should be maintained at all costs, however.

The monetary union must remain a stability union. Failure to achieve this will cause the single currency to fall out of favour. And that would undoubtedly be a heavy burden for the future of Europe.

6. Conclusion

European politics are becoming increasing difficult for the general public to understand. All the more important, then, that there are journalists who are not only interested in stories about public figures, but who also get to grips with complex topics and relationships to make them comprehensible for their readers. And the less the reader is personally affected by a story, the harder that becomes.

As the Chief Diplomatic Correspondent for Europe at The New York Times, you, Mr Erlanger, have the challenging task of bringing Europe closer to a predominantly American readership. Please allow me to say that, with your engaging as well as informative articles, you accomplish that task with panache.

Once again, please accept my sincere congratulations on being awarded the Karl Klasen Journalism Prize. And to you, the audience, thank you for your attention.

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[1] Deutsche Bundesbank (2017), The danger posed to the global economy by protectionist tendencies, Monthly Report, July, pp 77–91, and the literature cited there.

[2] K Klasen (1970), Die Verwirklichung der Wirtschafts- und Währungsunion in der EWG aus Sicht der Deutschen Bundesbank, in Europa-Archiv, 13, p 453.