

Kozminski and TIGER Distinguished Lectures Series
“The Euro Crisis – A Political or Financial Challenge?”

Joschka Fischer

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Grzegorz W. Kołodko: Good afternoon and welcome. It is exciting that we are able to host today His Excellency Joschka Fischer. As we are here, the new President of France is having lunch with six former socialist Prime Ministers, getting ready to take off to Berlin to talk over dinner tonight with the Chancellor of Germany, Angela Merkel. But our guest today, Joschka Fischer, was at a very important period of time Vice Chancellor and Foreign Affairs Minister of his great country – Germany. Things have changed since. Then we were working hard to be able to join the European Union, about ten years ago when Mr. Fischer was Deputy Chancellor and I was Deputy Prime Minister, I think neither of us, looking forward to the future in ten years’ time, imagined that in the spring of 2012 we will have such a severe crisis at the core of the euro zone.

Mr. Fischer is a man of state with many talents. He’s not only the man of state of his country but also, what has to be stressed, here at Kozminski University, an independent business consultant, very knowledgeable about economics and politics.

As to the euro zone and the title of Mr. Fischer’s lecture, we are really at a very interesting moment of time. The situation is very dynamic and if our lecture took place a week ago, I think there would be a couple of different questions than now, because the situation changes so quickly. But today we’re having a chance to discuss in a professional way the challenges we face in our European Union within the euro zone. Mr. Fischer, the floor is yours.

Joschka Fischer: Thank you very much. Excellencies, ladies and gentlemen, thank you for inviting me. It’s a great pleasure to be here in this beautiful city of Warsaw and to address this very important issue of the Euro crisis with the students of the business school here. When I was invited, however, I didn’t expect the ambassadors. So, I have to be careful about what I will say.

The European Union, and let me speak mostly to the young students, is a strange animal. Many governments outside of Europe do not understand the nature of this animal. What is it

all about? Is this a sovereign entity? Is it a cooperation of sovereign states? Is it an economic entertainment, a political entertainment? What is it all about?

Let me start by looking back in history. The question is whether the present crisis, which seems to be the most serious one in the history of the European Union, is a financial one or a political one. Obviously it is a financial crisis; it has a financial dimension. If you read newspapers day by day, you will understand that very easily. But the centre of that storm is not the European Union. It is the currency union – the euro zone, the euro group. Before going into more analytical depth about the dimension of the crisis, let me remind you that we are talking about a global financial crisis.

It all started in September 2008 with the collapse of the investment bank of Lehman Brothers. If you want to divide our times, you can divide them into before-Lehman and after-Lehman. It happened on a stormy Sunday in New York City, downtown next to Wall Street. When Lehman Brothers went into default, the whole financial system froze. This had consequences for the world economy – for China, for Japan, for the United States, for the members of the EU, for the UK and others. We are talking about a global financial crisis. It started as a private debt crisis, obviously. The system froze and had to be put on life support, artificial life support once Lehman Brothers collapsed.

This was also an explosion of a huge bubble, a super bubble. The governments had to react. Let me stress, ladies and gentlemen, the dimension of the financial crisis as a private debt crisis, with the consequences of a frozen global financial system, was as big as the crisis in 1929 or maybe even bigger. But this time, this was not the post- World War I period; this was a different time. Central banks, governments, and finance ministries knew how to act. So they fueled the frozen system, they unblocked the frozen system with a lot of taxpayers' money, huge amounts of taxpayers' money.

The consequence of that was that the next round of the crisis was seen as not any longer a private debt crisis but as a public debt crisis. For example, Spain and Ireland had a better public debt ratio than Germany before the crisis; this shouldn't be forgotten. Greece is a different situation. Especially Spain and Ireland had a much better public debt ratio than Germany. But with the infusion of hundreds of billions or even trillions of dollars of taxpayers' money to save the banks globally and to unblock the frozen global financial system, this crisis turned into a public debt crisis.

Now the consequence of the public debt crisis was obvious. Reducing the public debt would be the third step - we have entered this third step already – the so called austerity period. The consequence of the austerity period is, as could be predicted, that we are very close to entering the next stage where we will have to create growth. This will be the fourth step. I predict as the fifth step, once growth will be pushed forward, inflation will be the next challenge.

So what we see is a typical situation of a very serious disease, which has to be cured by a medicine that is dangerous. So the timing and the dose are the real issues. As there are many different doctors, they have different strategies and different meanings. Now if you're having a heart attack and are listening, if you are capable of doing that, to three doctors, one says we have to do A, the second says B, the third C. You won't feel very comfortable and that is the situation in the present state of affairs. So, we are in a global financial crisis.

But why is the euro zone, not the EU, in the centre of this global financial crisis? The answer lies not in finance or in the economy. I doubt, without going into the details, that the euro zone is in less good shape than the United States or the UK or Japan. If you look to the situation in the United States, for example, you will see states and cities where some of them are in a good shape, and others are in a terrible shape. I would not say it's as bad as Greece but some of them are very close to that. But the impact for the US economic and political systems is a very different one. The answer for that is not found in the financial or economic sector. My thesis is that the crisis of the euro zone has a very important financial impact, but in its core, it is a political crisis. I will try to explain it to you and then try to describe the consequences.

Why was the European Union formed as a European economic community? Were there economic reasons? Yes. Were they very powerful? No. Were there political reasons? Definitely yes. Were they very powerful? Yes. And what were the reasons? It all started with World War I, followed by thirty years of self-destruction. Unfortunately, my country was in the centre of this process of self-destruction. There was the Second World War, and at the end of this war, Germany had almost destroyed itself, not only in a physical way but also in a moral way. It committed terrible crimes, especially here in your country, in Poland. This was almost a complete defeat, not only in a physical way but also morally.

Europe was divided between the Soviet Union and the western allies. The Cold War started and in the West, there was the idea that the old European system, which emerged out of the ruins of the thirty years' war, from the First to the end of the Second World War, the system was completely failed, unable to work any longer under the modern conditions. So the basic idea pushed forward, not only by great European statesmen, two Frenchmen - Schuman and Monnet - but also by two American administrations – Truman and Eisenhower, was to create in Western Europe a new political system.

The genius of the idea was first of all, to use the strategic economic interest to build this new system and second, a new methodology. The economy was one of the driving forces for war in Europe, fighting about strategic influence, interest, and resources. So the idea was to integrate the economy. This was the basic driver for the new European system. So the economy was in the centre but the reason was a political one. It was not pressured out of the logic of economic competition. The methodology was to do what we can now and leave to the next generation the next steps if they are needed and if they are possible. This was an incremental approach.

But behind the idea of the EU is a political idea. It is not about the economy. The real reason was to integrate, especially France and Germany and all their neighbors, so that war was not any longer an option. Integration meant pulling together national sovereignties, at the beginning at a very careful pace, and integrating the strategic and economic interests at the same time. Creating a common market, so you are trading with each other and not fighting with each other. Creating common institutions so that in the future you will negotiate and not fight against each other. Have a common agriculture market. These were the drivers for the political purposes of integration, and it was a success story.

Looking at your country today, Poland, it is a fantastic success story. The European Union, together with a security guarantee by the United States for Western Europe and now for the whole of Europe, were the key elements of peace and stability. Looking to your own country, I remember the debates before Poland decided to join the European Union. I will never forget that there were real concerns among the Poles that the Germans will come back this time, not with tanks but with a check book, and will buy sacred Polish soil.

In Germany we thought we would be flooded by cheap Polish labor and we would lose our jobs. Now if we are looking to the border, what will we see in the northwest of Poland, just

northeast of Germany? Polish citizens are crossing the border without controls and are buying property in Germany – sacred German soil. German workers are going to Poland for jobs today. So just the opposite happened to what was predicted. Poland is a wonderful success story, which demonstrates how the EU is really working. The influx of money in the common agriculture market, infrastructure financing and so on, the modernization effect of the EU is a fascinating development. On the other side, however, we are still far away from real integration.

But let's come back to the present financial crisis. What we see now is that the enlarged EU with twenty seven members was hit severely. When the wall came down in 1989, everybody understood that this will be the moment when Germany will be reunited. The US understood it immediately; some other states had problems, understandable ones. But at the end, the idea was that Germany would be reunited. To preserve the success story of European integration, Europe has to move ahead with this integration and form a currency union. It was all about deepening the integration on the background of German unification. We shouldn't forget that.

That was the real reason. Was there a financial need? No. We had a financial system. The Deutschmark was the regional currency, the reserve currency and the others were more or less firmly connected to that regional currency. Now the Deutschmark under German law was supervised by the German Bundesbank, but it was now reunified Germany in a reunified Europe. The idea was that we have to integrate because it might create problems if we continued with the old system under the new conditions. Again, these were political reasons.

So the Euro was formed for political reasons. That is the point to understand when we talk about the consequences. So please do not forget that element of my argument. The Euro worked well, but I think the Maastricht construction had a major weakness, a typical German weakness – Germans believe in principles. So if you have defined the principle, everything is fine. But unfortunately, the reality is developing in a different way. Principles are fine as long as the reality is not moving in a different direction.

Germany was in a complicated situation – reunification was quite a challenge for my country. We were at the end of growth – wages were going down, pensions were going down. So Germany had to struggle very hard while others were celebrating a party. Germany had to work very hard to deal with the financial, social and economic consequences of the unification. In the next step of the EU enlargement, which was in the interest of everybody in

this serious situation, even Germany had to break the rules of Maastricht around 2004-05. It happened in direct connection with the beginning of our reform policy that made the turnaround.

Would we do it again? Yes. Why? Because we needed some air to breathe. We were moving ahead with a huge reform program of our welfare state, our labor market and so on. Everybody agrees today in Germany that that this was a huge success story, but it was done not according to the rules. Others acted in the same way. The crisis then made quite clear that a principle-based currency system is not viable under the stress of such a huge crisis. This is because the governments will always act according to their immediate interests and not with the agreed principles if the house is on fire. Now, I think that the big mistake of the austerity compact, or whatever you call it, is that it is still sticking to the idea that the principles must be implemented. If not, then this is the new promise, the European Court should be appealed to, and then there should be fines put on governments.

However, to punish with fines the government that is in financial stress or at the brink of a huge financial crisis definitely makes no sense. This is because it would only accelerate the crisis and not reduce the crisis and contribute to a more positive behavior. That is my experience. So we are facing in the present situation the challenge of how to survive as a currency. This is the major challenge for Europe. The contradictions in the euro zone are that the economic and financial contradictions are almost too big to keep the euro zone together. It is still a currency with the Central Bank but we do not have a common fiscal policy. We do not have a common treasury. We do not have a common government. It is still just in a framework.

For our American friends in the room, the EU is presently in a similar crisis as the US was in the 18th century after the successful war of independence against the British Crown but before the Philadelphia constitution. At that time, it was a genius of Alexander Hamilton who pushed the young United States forward from a confederation into a federation. But the reason was exactly the same. The confederation framework of the young United States did not work and the US was at that time on the brink of disintegration, and this would have led to the failure of the founding of the United States. We should not forget that. Consequently, this shortcoming was healed in the constitutional process in the Philadelphia Constitution. By the way, Switzerland was in a similar situation in 1847. It was the so called Bundskrieg where the

inner cantons wanted to preserve a confederation and the cities and the city-based bigger cantons were fighting for centralization.

This is exactly the situation we are facing now in the European Union. Europe is based on solidarity, but solidarity is not endless. You cannot have a situation where some will pay taxes and others will not pay taxes. You cannot have a situation where retirement will start at sixty or less than sixty and others will do that at sixty-seven. You cannot have different budgetary policies. So all of what is called a fiscal union is urgently missing. It was not a problem as long as there was plenty of money around and finance was not an issue. I think it was Warren Buffet who said 'Only when the tide is coming out, you can see who was swimming naked'. Now we can see.

Europe is in the centre of the financial crisis because we urgently lack the political framework to deal with this crisis. It will not be easy to create that framework. But let me be quite or even brutally clear. If the euro zone starts to disintegrate, the European project will be dead. The common market will be the next victim and the whole European project will unravel because if the Euro Group falls apart, the spirit of the European project will disappear. With the spirit of the European project gone, the interest will continue, and maybe even the legal framework will continue, but it will be more or less an empty shell.

The European idea will disappear. Without this idea, nationalism, egoisms, all the problems that European nations know very well will come back. Solidarity will disappear. Europe is not an institution based on interest alone. It is based also on an idea. It has a soul and this soul depends strongly on the success of the euro zone. Let me say that here in Warsaw, in the short term, you might have, as a non-Euro Group member, some benefits from the present crisis. But if this crisis develops into a disaster, then the non-members will also be severely hurt. We shouldn't forget that.

Can we get out of this crisis? Yes, if there is courageous leadership, the most needed resource in Europe nowadays but hard to find. We still discuss the crisis mostly in financial terms, but I think as long as we are sticking to the financial discourse, there won't be an outcome. Our people, and I'm talking now about the members of the Euro Group, all our people still think there's a way back. Many citizens in the crisis-ridden economies of the Mediterranean and in Ireland are fed up with the austerity policy which they think has been imposed on them. They

are in the state of despair. At the same time, countries in the north are in the state of rejection. This will lead us to disaster if we continue on these two different tracks.

I think we have to go to the fundamentals. I think there is a possibility of a *quid pro quo* to overcome and settle the crisis, but only if our leaders will have sufficient courage. It's obvious that the euro will survive only if we move into a fiscal union. Without a fiscal union, how should it survive? The Greeks won't have ten years of depression without going crazy. Everybody would suffer that, including myself. On the other side, I don't know how long Germany, Finland and others will remain ready to invest in the future of the Mediterranean member states, and how long the pressure of the markets can be pushed back. Everything will fall apart without a fiscal union.

A fiscal union means a political union. There is no other way. All will have to pay the extraordinary high price for unraveling of the euro zone. Since 2009, things have happened that I thought would never happen during my lifetime. At the beginning in Germany, there was a sacred "no bail out" clause in the Maastricht Treaty. Our constitutional court seemed to be more powerful than our elected government. Then one day in 2009, and I will never forget that, there was a Thursday discussion in our Parliament in which Angela Merkel presented a small bail-out package – the first one. There was big unrest in the coalition. Conservatives, business-friendly liberals and the Chancellor cooled them down by saying "That's it". In the afternoon she traveled to the summit in Brussels. There, the President of the European Central Bank, Jean-Claude Trichet, showed the leaders of the Euro Group that the markets have begun to freeze again and urgent action was needed. Suddenly the "no bail out" clause was history. Nobody in the German delegation was thinking any longer about our constitutional court.

By the way, the constitutional court accepted that de facto in another decision later on. Then suddenly, they created a huge rescue package. Why was that? Because they looked into the cold abyss of disaster. So they made a tremendous jump on that weekend. Nowadays in the Euro Zone is that any longer a national issue or is the Euro a group of heads of states and governments? Did the group of heads of states and governments not develop in a direction of de facto European government? What we see is that the European institutions are redefined. The Commission is de facto playing the role of the administration of this new formed European government called heads of states and governments in the Euro Zone. The parliament, the European Parliament is unfortunately sidelined, but the national parliaments

are the real decision makers. Why is that so? Because they are the caretakers of the budgetary sovereignty. So what we see is an emergence of the new structure in the Euro Group. We see a de facto European Government formed by the heads of states. The members of the Euro Group are acting together, however, not in a formal way. This is a very dangerous shortcoming because it is seen that Germany is dominating everything. It's power-based and not group-based. This must be changed as soon as possible in the interest of the whole project.

But the direction is very promising. The same is true with national governments. Suddenly, the national governments have a European role in a very direct way. I think about what would have happened if there had not been a sort of Euro Chamber and Greek, German, Spanish, and Finnish Parliamentarians – all the representatives of national Parliaments - would have had to discuss the crisis directly with each other. I think this would have made an important difference. So what we can learn out of these developments is that we can see the elements of a federation, of a federal structure for the Euro Group. Unfortunately, the leaders everywhere, starting with my own country, do not have the courage to develop a new vision based on this experience, on these real developments.

What we need is this new vision. I think citizens are open to such a vision. It's not about how to explain how much we have to pay for this and that. That's important but only a vision can change perceptions. It's a political challenge. Let me be quite frank. If the Euro should survive, I think north and south have to reach a new agreement. There will not be a survival of the euro without a transfer union. Everybody who's telling his audience in the rich countries that transfers are taboo is dishonest or will destroy the euro. Sorry, and don't blame the messenger for the message. The future will also need for the deficits to be at least partly guaranteed within the Euro Group. Now that I'm being brutally frank, ambassadors, don't be shocked, I mean the ambassador of Finland and the representative of the German embassy. It all started a long time ago.

There is the story of Alibaba with his password that opens the treasury. There is such a word now for a negative treasury, it's called Target. It's very simple, there's no way back without ruining yourself, and we can't stay where we are. Target is nothing mysterious, but there is no need to explain it here in detail. However, as long as the euro exists and the European Central Bank exists, it's only about accounting. But at the moment if the euro zone fell apart, then because of Target, Germany and also Finland and some others could not get their money back. It's very simple. So it all has started; we are in a transfer situation. The European

Central Bank is buying assets on the secondary market from the Mediterranean countries; otherwise the interest rates would have sky-rocketed in the past. The question is when it will be ready to draw the consequences of these developments.

It's not really understood what unraveling of the euro would mean, even for the richest members of the Euro Group. It's easy to make an omelet out of eggs, but it's a hell of a challenge to make eggs out of an omelet again. This is the very reason for my optimism. We can go on in a way as I said. We will have a transfer union. We will also have, and I don't know why my government is so hesitant to accept that, a transfer mechanism and a common guarantee of the Euro bond debts. I think it's the best instrument to achieve these goals. I think direct payments are much more complicated in the political sphere. But on the other side, it's also obvious to the crisis countries that the combination of the structural reforms is needed. This must be a *quid pro quo* that the stability is transfer-based and transfer is stability-based. For that to happen, we also need the courage to take two steps ahead into a currency union (step one) and into a political union (step two). I don't see a serious alternative to this beyond disaster. However, the way ahead won't be easy.

Prof. Kolodko mentioned the visit of President Hollande. It will be all about growth. Both sides needed it. I don't understand why we aren't using our strengths in the 21st century with the rise of China, India, Indonesia, Brazil and all the others. With the fact that 7 billion people are living today on earth; it's a completely different world and will be in the future. The new world will be a very different one. Sustainability is not any longer a question of ideology. China will be the first economy, which will be forced to agree on revolution. They don't have an alternative to that if you look at the figures. Europe is well positioned. We must invest more and, sorry to say, I see an important difference between investments debt-based and debt which is consumed today. Investments are urgently needed and we have assets here compared to other regions in the world. We're well positioned.

Nobody can stop the Europeans from integrating their energy policy. Yes, some are pro-nuclear, others are against nuclear, but we can live with that. We should push forward with the ideas we have in common. A European-wide energy policy, a common energy policy, nobody can stop that except ourselves. We're moving into a knowledge based society. The EU developed a great idea some time ago and formulated it very precisely in the so-called Lisbon Agenda. The only shortcoming was it was not binding, and nothing that is not binding is really working in the EU. But the idea to invest into the future for a knowledge based

economy and be the most modern knowledge based economy in the EU. Together with an integrated low-carbon energy policy, this offers at least two ideas: 1) whether the European Union can move ahead with relations without the southern neighborhood; and 2) North Africa and sub-Saharan Africa being based on energy cooperation with renewable energies.

So, there's not a shortage of ideas. There's not a shortage of opportunities. We shouldn't buy the thesis that Europe is old, China is much older, and so what? Our Chinese friends are demonstrating that age is not a problem. The question is whether you're old in your mindset. Now our Chinese friends proved that you can do it. We need to open up and draw the political consequences of this crisis. It means fiscal union and political union for the euro zone. Whoever wants to join, should join. This is not an exclusive group. It's an inclusive group.

The current crisis offers a huge opportunity for all of us. It will be a hell of an effort. It will be bumpy, there'll be a lot of noise, shouting, setbacks but that's normal in politics. But don't forget what your grandparents, my parents, your grand grandparents, my grandparents had to go through. We should understand that the common union is also the best guarantor for peace. Who will take care of our interests? Our Asian friends? Why should they? They haven't forgotten what the Europeans did to them in the colonial era. Why should they? They are looking after their own interests. It's payback time. I would see it in the same way. Our American friends will support us, but they have a lot of problems at home and have to deal with them first. But I think America will make it. I've no doubt about that, but in relative terms, the power of the United States will be reduced because others will move upwards. It will be a different world and America will be drawn into the Pacific Rim. They will not lose interest in Europe but we will move out of their focus. So who will take care about European interests in the future? Our old-fashioned national states? Come on!

I will never forget when Ho Jintao traveled last time through the European crisis belt in the south, including Hungary. His message was quite clear: "We are ready to help but we need to be paid back in influence." It's not a good deal from the European point of view; only Victor Orban was thrilled about that offer but that's a different issue. It's not a good perspective; therefore what we need is a stronger Europe. We know how it would look. We know that it's seriously complicated to push through. However, the euro zone disaster is not an option; therefore I'm an optimist. Thank you very much.