Reform of European financial regulation – improving Europe's constitution

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INTRODUCTORY NOTE

Last December we published a break-in by Guy Verhofstadt, former Belgian prime minister, calling for further integration to overcome the euro crisis. Today we would like to carry the debate further with an input from Dr. Wolfgang Schäuble, the German Federal Minister of Finance.

Minister Schäuble put forward his ideas on reforming European financial regulation and improving Europe´s constitution in a lecture held at the Humboldt-Universität zu Berlin. Humboldt lectures have had a special tradition in Germany, at least since May 12, 2000, when Joschka Fischer, then German foreign minister, , delineated his far-reaching vision for a united Europe. It should not be concealed that he did so explicitly in his personal capacity.

Dr. Schäuble delivered his speech as German Finance Minister. Obviously, this calls for more sobriety and sense for the demos. Yet his speech is not less visionary. And it is by no means old-fashioned to remind the Germans of what it owes to European integration and how much they will rely on this very integration in the future, if they want successfully to cope with the increasing systemic risks.

The challenges of globalisation have it that we badly need a stable currency. Yet the euro will only be trusted again if member states of the eurozone manage jointly to define their economic, fiscal and social policies. That does not mean to build a European super state, but striving for political union would surely help. In any case, the euro will not survive if member states get away with notoriously breaking the Stability and Growth Pact and piling up huge deficits. Neither will the euro survive if economic policies remain uncoordinated and economic imbalances are growing further instead of scaling down.

These failures of the past retaliate in the current crisis. By now no easy solutions are at hand and politicians face a dilemma. Whereas the boom in Germany calls for a rise in interest rates to guard against inflationary risks such a step by the ECB would hurt the states in Europe´s periphery and rob them any chance to recover economically.

Under the pressure of financial markets member states in the eurozone have been sallying out to set new and biting rules long overdue. The contested Franco-German proposal on a pact for competitiveness put forward last week is among these efforts. Whether they will make a difference and re-establish trust in the currency remains to be seen. They all carry the stigma of intergouvernmentalism and will be enforceable if all can agree. Thus, the best is to be hoped for.

Above and besides all the new regulations put in place or under consideration it still remains unclear how the EU can recover from the damage inflicted by the past. It seems pretty clear that Greece can only escape default if it gets a debt relief. The rescue package has only bestowed a respite. It will do nothing to let Greece recover from depression however bold the country's savings will be. As core country of the European Union Germany will be bound to take on responsibilities for these problems. If a solution for state debt crisis shall be found private creditors have to be called in. This contribution by the Federal Minister of Finance illustrates his thoughts on this as well as other issues – thoughts of a staunch European.

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This evening I will be speaking German, although I must add – for the benefit of the audience here in the capital – that those of us who come from Baden-Württemberg may be able to do many things, but speaking standard German isn't one of them. Having said that, I want get straight to the point. In 1950 – it must have been in June – Konrad Adenauer entrusted Walter Hallstein with the task of heading up the German delegation at the negotiations for the Schuman Plan, which were held in Paris. The negotiations aimed to establish the European Coal and Steel Community (ECSC). On the face of things, it appeared that the ECSC would essentially be about industry and economic policy.

In truth, however, the aim was to secure peace in Europe. It was not long after the Second World War. At the time – five years after the end of the Second World War – coal and steel were synonymous with the arms industry, and thus bywords for military and political power. So the Allies, in particular, viewed these negotiations on the ECSC primarily as political talks. Even at that early stage, the Allies – and also the Federal Republic of Germany – wanted to engage soon afterwards in further negotiations towards a European Defence Community (the EDC) and a European Political Community. The ECSC talks were therefore a mere precursor to the more in-depth negotiations on a European Defence Community and a European Political Community – or at least, that's what they were intended to be. To some extent, they were supposed to serve as a pilot project for other, more comprehensive community institutions in Europe.

At the Messina Conference in July 1955, where the foundations were laid for the Treaties of Rome, and thus for the establishment of the European Economic Community, the desire to achieve political integration was even clearer. It was then that we heard the first mention of – and now I will say it in French – of the *finalité politique* [ultimate political aim] of the integration process, and of the need, through the specialised communities, to work towards the true goal of a full political community. For the younger people here: the plural was used because there were indeed three communities: the Economic Community, EURATOM and the Community for Steel and Coal. Unfortunately, the defence community project failed in 1954 at the hurdle of the French national assembly. Since then, there is a basic principle which directs European integration – and this is clearly true even today – namely that economic unity precedes political unity, but is intended to lead to political unity. So economic developments often lead the way, ahead of political developments, and help to shape political developments.

Essentially following this principle, the European Union has, since its foundation, developed into a new form of supranational governance – that is, a form that Germany's Constitutional Court describes as *sui generis*. This European Union marks the start of something new. Something new that extends beyond the classic understanding of a nation-state, because it breaks through the nation-state's absolute monopoly on regulation.

We lawyers have always debated whether it is a federal state or a confederation of states. This debate has long been outdated. The European Union is neither one nor the other. It is unique. It transfers sovereign power to several different levels – that is what is new. And that is incidentally why I am convinced that it represents the ideal political and institutional response to the challenges of the 21st Century, particularly globalisation. And if we ask why these developments in Europe have attracted such great interest in Asia, and why it is also in Asia's interest for the European model to succeed, then the answer probably lies not least in this unique principle of construction, which involves adding to the nation-state, or in some cases, transferring it to a new form of international and, ultimately, also global, governance. But why have I taken us on this excursion to the beginnings of European integration? Simply because today, as a consequence of the euro zone crisis that broke out last year, a path leading to more political integration again lies before us.

European construction relies on the specific principle that European Monetary Union is not accompanied by a political union, and each country determines its own budgetary, fiscal and social policy. We are currently seeing extremely jittery financial and capital markets put this principle the test, to determine whether, and to what extent, it can and does work. This was the reason why many people were sceptical at the time when Monetary Union was brought in. Not only in our country, or in Europe – the scepticism was even stronger in the Anglo-Saxon countries, because they thought that it would never work. For a long time, it was relatively difficult to find anyone in the United States of America who believed that things would more or less work out with the euro. Since then, we have largely managed to prove those doubters wrong. But the crisis has put the issue back on the agenda. And this basic question is presumably the main cause of our current problems, because – and this is something we can debate for a long time: is this a crisis of individual countries, or what is it exactly?

The basis for the danger of contagion is that the people who make decisions about financial resources and investments, for example, managers of large capital funds or American pension funds, say 'we somehow don't really trust this. We're not really convinced that it can work.' And that's where some of this nervousness is coming from. The last few days and weeks – yesterday in particular – have fortunately shown us that the nervousness is not quite as great as many predicted.

But these events and this discussion essentially mean that the prophesy Jean-Claude Juncker made on the eve of the euro's introduction in cash form on 1 January 2002 has been fulfilled. He said: "The euro, one day, will be perceived as the father of all things European. The euro compels us to engage with European issues at an existential level, to steer them into the right channels." Ladies and gentlemen, that is the very point we have reached now. We must now attend to the most important European question: What is the way forward for political integration, particularly in the areas of economic and fiscal policy?

And of course, we must frame this debate, including its economic and fiscal-policy dimensions, in the context of constitutional law and constitutional politics. On the one hand, the nation-state has indisputably lost its monopoly on regulation. In my view, if I can just say this, we certainly took our time to form this nation-state – the foundation of the German Empire eventually came under Bismarck – or, as Helmuth Plessner put it, Germany was a "belated nation". And having got there so late, we then did what most converts do, and took things too far. And then everyone failed to comprehend the disaster that was the First World War – not only the Germans, but all the people of Europe at the least – or in any case, we failed to learn the right lessons from it. And then we had Hitler, the Second World War, and the division of Europe. And only then, with the unification of Europe, did we achieve something new.

That's a very abridged version of history from 1870 to 1990. But in essence, it reveals something of this process, of the end of the monopoly on regulation. I believe that other people have sometimes described this as the Westphalian system. And there are many other issues that play a role here – I just wanted to touch on that. That is one side of the story.

The other side is that no-one wants a European super-state. A European super-state would basically just be an attempt to transfer the monopoly on regulation characteristic of the outdated nation-state to a larger unit. That would not be new. Nor would it be worthwhile. And that is why we need something new – *sui generis*, as the [German] Constitutional Court said. Although we lawyers have something to confess to the non-lawyers among us: When lawyers can’t get something to fit into existing categories, they fall back on their Latin and say ‘*sui generis*’.

But the result is that the problem of ensuring political decisions are made on a legitimate democratic basis arises in a new form. That is one of the institutional problems. The Lisbon Treaty addresses this problem, as does Germany’s Constitutional Court in its case-law on the matter.

I do not want to go any deeper into the issues of constitutional law at this point, because I am here as the Minister of Finance, because I want to stay on topic and because we want to have enough time for discussions afterwards. But there is one small thing I point out again and again when I am talking about European unity to people who are interested in constitutional law. What I point out is that – and let me put it this way for the law students: sometimes it’s worth your while to have a look at what the law says. That includes the constitution. If you occasionally dip into Germany’s constitution, and if you start at the front, in the preamble – which has remained unchanged in this point since 1949; we did not change it during the reformulation in the Unification Treaty between the two Germanys, and I can be sure of that because I was quite closely involved – you will read the following aim: the German people are “inspired by the determination...” – and now here it comes, word for word – “…to promote world peace as an equal partner in a united Europe”. The fathers and mothers of the constitution had an exact and lucid knowledge back in 1949 of what was needed to give Germany any hope of gaining what Fritz Stern has termed its “second chance”. And today too, having experienced 60 years of good fortune, we should not forget that fact – not even during discussions of constitutional law.

Before explaining my own thoughts about enhanced cooperation on economic and financial policy in Europe and the euro zone, I would first like to note a few points that are significant when considering how we can stabilise the euro and European Monetary Union on a lasting basis, and why it is in our interest to do so.

The first point I want to make is that, at the heart of the matter, we are not experiencing a crisis of the euro, but crises in individual countries that belong to the euro area. These crises were caused by the individual countries’ erroneous economic and fiscal policies, as in the case of Greece, or were caused by a banking system going off the rails, as in Ireland. It is quite clear that we are faced with individual sovereign debt crises or public-sector budgetary crises in individual countries, and not with a currency crisis. This is demonstrated by the simple fact that the external and internal value of Europe's common currency – despite all the turmoil – has remained impressively stable. The President of the European Central Bank, Jean-Claude Trichet, rightly points out time and again that the euro’s internal value, expressed by inflation in the euro zone, has stayed below the ECB’s two-percent target on average. To be absolutely precise, we did have a minor exception in December last year, when the figure hit 2.2%. But you can see that in the long term, the internal value is very stable. In the eleven years since it was established, the European Central Bank has regularly been able to boast lower inflation than the Bundesbank achieved in the days of the Deutschmark.

The euro’s external value has performed just as impressively. The euro is currently worth – it’s rising slightly at the moment – but it’s back up above USD 1.35. At the time of its introduction, it traded at just USD 1.18, and when it was brought out in cash form, the euro was below parity with the dollar. So at today’s value of USD 1.35, the euro can hardly be described as weak – and that goes for both the external and the internal value. The promise we made at the outset, namely that the euro would be at least as stable as the Deutschmark, has been kept to this very day. The European Central Bank is fulfilling its mandate, and there is no doubt whatsoever that it will continue to do so in future, and that it will thus further strengthen confidence in the euro. We have delivered price stability, which is exactly what the German people expected – and indeed were entitled to expect. It is evident that the tradition of a stable currency, which we had with the Deutschmark, lives on.

My second point is that Germany’s imports and exports mean that we are more deeply embedded in the system of international division of labour than any other comparable country. If we look at our combined imports and exports as a share of gross domestic product, we see that our interconnectedness in terms of international division of labour is twice that of Japan – to give just one example of just how strong this connectedness is.

That explains why the effects of the financial and banking crisis in 2008 hit us harder than other countries, leading to a 4.7% contraction in GDP in 2009. Growth of 3.6% last year meant that we recovered most of that amount. And now there is little argument – nationally, in Europe, and less and less argument on an international level – about the fact that determinedly reducing excessive government debt does not starve growth, but nurtures it sustainably in the long term. The American President said the same thing in his State of the Union address yesterday. I was delighted to hear it, because half a year ago, we were still forced to defend ourselves against the accusation that our deficit reduction would hamper global growth. It has since become clear that we are not a brake to growth, but rather a motor.

The German Council of Economic Experts has predicted that this year, in 2011, the majority of our growth will come from domestic demand. Yet without our successful exports – and I say this even though domestic demand is now catching up – this would not be possible. And the success in exporting, in turn, would not have been possible without the common currency, which has largely protected us from exchange rate fluctuations. This is something we need to repeat again and again. Take the banking crisis from 2008 onwards. We would have seen large distortions in the system of currencies, particularly in Europe. Exchange rates would have risen and fallen incessantly. And the result would have been terrible damage to our economy. Almost two thirds of our exports are destined for other EU Member States, which means that we are largely unaffected by exchange rate fluctuations. That would not be possible without the common currency. And that is why, when you turn up at a European-level meeting as the German Finance Minister or another representative of Germany, you are surprised to find that most other people don’t see us as benefactors of European Monetary Union. Instead, they say that we enjoy the greatest benefit from the single currency. And we reply that we benefit because of our competitiveness. And I don’t dispute that; but it sometimes doesn’t hurt to gain an understanding of other people’s perspectives.

Now to the third comment I want to make. When the Stability and Growth Pact was drawn up, back when European Monetary Union was founded, the interconnectedness of the financial markets, which became visible during the financial and banking crisis in 2008, had not yet been foreseen.

And there was no way it could have been foreseen, because it involved the unbelievable advances that have been made in communications technology and the fact that markets throughout the world are now separated by less than a second, which leads to volatility beyond anything we were previously able to imagine. We used to believe that the different rates of interest paid by the single currency's members would be a sufficient incentive and sanction to keep countries within the mutually agreed framework for fiscal policy and for deficit limitation or reduction. And in principle, that is true. For this reason, we are convinced that we cannot do away with the threat of higher interest without an adequate replacement. If we did, it would shut down the mechanism by which the Stability and Growth Pact operates. That is, if you do not manage your economy well, you will pay higher interest. And if you manage your economy well, you pay lower interest. And if a country is ultimately unable to bear the interest burden, the support mechanism takes effect, accompanied by strict conditionality.

All of that works. But what we failed to predict in the beginning was the systemic risk. And it is for this systemic risk, that is, the risk that one country's debt crisis will prove contagious for other euro members and for the euro zone as a whole, that the mechanism fails to make adequate provision. That is what we experienced last year. And that is why we must work to develop the instruments at our disposal. So now we have come to the heart of the matter. We need to be clear about the situation. Greece accounts for around 2.4% of the euro zone's total economic output (that's less than my home state of Baden-Württemberg, just to give you an idea of the relative size). We could never have imagined that a sovereign debt crisis in such a relatively small country could affect the entire euro zone. Yet the fact is that the Greek crisis, just like the crisis in Ireland, weakened confidence in the euro as a whole. And that is why the question of how to strengthen the euro zone as a whole is a systemic question, to which we must find a systemic answer.

There is one comment I would like to add at this point, if I may. This is also a point that sometimes does not come across so clearly in public discussions. All of us, all the members of the euro zone, require large volumes of financing. Germany's central government alone, without even talking about the *Länder* and municipalities, needs to borrow more than 300 billion euros on the financial markets this year. We can do the maths: the government has existing debts of around €1,000bn (the figure's actually a bit higher, but a trillion is enough to work with for now). And some of this debt is due to mature. If we assume the bonds have an average term of five years, the German government has to refinance €200bn every year . And new borrowing comes on top of that. The result is that Germany's finance agency has to place more than €300bn in the financial markets this year. Every day, we have to convince those making investment decisions on the world's financial markets that they should invest in the euro, and in Europe.

The members of the euro zone require €500bn in financing in the first three months of this year. So if those responsible, let's say for an investment fund, let's take the pension fund belonging to a teachers' union or association from California – if the manager of that fund says: 'be a bit careful about investing in the euro', and sets certain limits, then that is one of the problems that can very quickly become a problem for the euro zone as a whole. That, in a simplified form, is the explanation of why we have systemic risks – to which we must find systemic answers. One of these answers is that we cannot merely demand more budgetary discipline in all euro countries. We must also make sure that this discipline is actually in place. It is also vital that we look at more than just government budgets. We must consider the individual members' economic strength, too, and better co-ordinate economic policy to avoid overly large imbalances between Member States. However, this cannot take the form of successful countries voluntarily limiting their competitiveness. The only workable course is to improve the position of those who are somewhat weaker. That is now generally agreed. And we also need the right tools to combat the risk of contagion for the euro as a whole, should a crisis arise.

To repeat: a strong common currency is the foundation of our shared economic success. Over the course of last year, the realisation gradually dawned that we depend on the success of European unification and the common currency. To that extent, the crisis has done some good. All the opinion polls show that for all the concerns, that realisation has grown. We did the right thing by lending to Greece and then putting together a package to protect the euro overall, even though it can be hard, of course, to bear the consequences of other countries' mistakes. But I am confident that our fellow citizens are increasingly aware that we need to do so in the carefully considered interest of Germany, in our own carefully considered interest. And what the German Chancellor said, and has been quoted as saying, is also true, namely that the euro is make or break for European unification as a whole. And in view of the challenges that globalisation creates for European unification, Germany and its neighbours have no better economic alternative and no better political alternative. The world's economies are highly interconnected and the division of labour is an international phenomenon. We depend on global developments in the areas of security, energy and raw materials supplies, as well as in the field of protecting the environment and climate. With all this in mind, each individual European country – including Germany, home to but a rapidly declining 1% of the world's population – we are all too small to defend our interests and live up to our responsibilities adequately. We can only do so if Europe acts together.

European unification has given us the most valuable gift of all – even if it is a gift that is taken for granted and often not appreciated. I am talking about the longest period of peace that the countries of Europe have ever experienced. Of course, no-one today seriously thinks that there could be a war between France and Germany, and that can no longer serve as our rationale. We do not need the euro to prevent war between France and Germany. But that is not a bad thing. In fact, it is a great success, if you have any understanding of history. And it is good that the younger generation says: 'stop going on about all that old stuff; it's ancient history now'. But it does not mean that tensions and divisions have lessened in this global age – we need only consider the issues surrounding raw materials and energy, for example. Or just think for a moment about the problems and challenges the African continent is going to pose for us. Take a look at the challenges coming our way from Tunisia. Perhaps opportunities too. But the transition must be seen as part of the big picture.

So however we see it, we need a Europe that is united politically and economically in the coming decades of globalisation. This need is as great as in the decades that have gone before. Back then it was the lesson we learned from two world wars, and then Europe gave us a way of preserving peace and freedom during the Cold War. Today, we need European unification as a contribution to global governance, which is the channel through which we must strive to keep the tensions and distribution conflicts throughout the world under some degree of control in this 21st Century. Perhaps we will manage to be a little more successful than we were last century. One hundred years ago, we had also reached a fairly advanced stage of globalisation and were very optimistic; and then disaster struck.

Now, we are at a faculty of law, and indeed I myself am a lawyer. So I want to avoid giving the impression that I am seeking to justify Germany's commitment to the euro purely on economic and political grounds, and that I am somehow shying away from giving a legal appraisal of the measures designed to stabilise the euro. And at the latest, we'll be having words about that in the Bundestag, as my colleague Mr Krichbaum here knows. There are some who question whether the crisis management measures taken in 2010, specifically the assistance for Greece and the euro rescue fund, are compatible with primary EU law.

I am not one of them. Every member of the euro zone was, and still is, responsible for its own liabilities. The no-bail-out clause has not been infringed. The assistance measures provided are loans, which are subject to clear conditions, and adherence to these conditions is monitored. The conditions require a shift in policy, budget consolidation and the implementation of structural reforms. The aim of all these requirements is to get the countries concerned back onto a path of sustainable growth. The European Central Bank, the International Monetary Fund and the European Commission monitor whether these conditions are met. The loans are not transfers. And they are not gifts. Besides, there has hardly been a rush of takers for the rescue package. Everyone has been fighting bitterly to keep their distance. Because the truth is that the mechanism works. It starts with the spreads: the higher interest rates become unbearable and a country needs support. And the conditionality is such that the country is compelled to enforce measures that would have been unthinkable before the event. Ladies and gentlemen, as the German media haven't always been too kind about Greece in the last year, I would like to add this: Greece has now adopted adjustment measures that hardly anyone would have thought possible. And that shows that the mechanism works in principle.

The assistance for Greece and the measures under the stabilisation mechanism are compatible with our constitutional and European law. The measures taken by the Member States were urgently needed to defuse the threat to financial stability in the European Union and, ultimately, to the euro as a currency. Irrespective of whether the no-bail-out clause in Article 125 of the Treaty on the Functioning of the European Union (TFEU) actually covers the bilateral measures agreed in this specific case – and I believe it does not cover them at all – but in any case, even if we decided that the Article covered these measures, it would still not be infringed by them. It is true that Article 125 of the TFEU is intended to ensure euro members exercise budgetary discipline by compelling them to borrow at market rates. But if the Member States had decided against the measures to support Greece, we could well have faced serious consequences in the euro area and beyond. Against this background, taking recourse to Article 125 without thinking about its purpose would have posed a grave danger to the euro zone's economy and currency in all the member countries, including Germany. Applying the Article would have led to the very outcome that it was designed to prevent: it would have put the entire euro zone in danger. Article 125 of the TFEU is not well suited to cases where there is an existing acute threat to the euro system's financial stability, with the systemic risks and consequences that brings. And that is why the euro area countries rightly decided to act.

The EU assistance within the framework of the rescue fund is also compatible with constitutional and European law. Article 122 paragraph (2) of the TFEU authorises the EU to take emergency financial measures. The Council based Regulation (EU) No 407/2010 on Article 122 paragraph (2) of the TFEU. The financial stabilisation mechanism is a permissible emergency measure. It is not a permanent structure, and the strict conditionality puts paid to any superficial talk of a 'transfer union’. There is certainly scope for arguing about transfer unions and what is behind them. But the conditionality completely dispels the notion of one party paying for others who are less hard-working. And I repeat: if this were not the case, if the rescue package were an easy cure, it would be hard to explain why ailing euro countries are not jostling to take their medicine, but, in light of the risk of systemic contagion, are having to be forced to swallow the pill.

Referring back to the fundamental principle by which European unification is structured, recent events have shown that a common currency cannot survive without solidarity between its members – solidarity that must be bound by clear rules. This solidarity cannot consist solely of the obligation to support member countries in difficulty. Solidarity also requires willingness to deal with the causes of their problems. Solidarity is never a one-way street. That is why I have fought hard on the odd occasions when the Commission, too, has created the impression that solidarity is only a requirement for the six euro countries with a triple-A rating. Perhaps we need to point out that of the 17 Member States that share the single currency (there have been 17 since 1 January), six (France, Germany, the Netherlands, Luxembourg, Austria and Finland) are rated triple-A. Only six. And European solidarity cannot be limited to imposing requirements on these six. Everyone must contribute, and especially those who caused the problems.

So what is the way forward from here? Now, you will of course understand that, as Minister of Finance, I have to limit myself somewhat when it comes to putting forward creative suggestions. So you can’t expect any fantastically visionary ideas from me today. They would only prove a disturbance, at least for the financial markets. And perhaps also for other discussions in the political sphere. But I don’t want to go any further on that. However, bearing in mind that caveat, I will say that in the short term, it is important that the European Monetary Union’s existing institutional structures are capable of obliging euro members to adopt fiscal and budgetary policy that reflects their responsibility for the common currency.

As I have explained, the incentive and sanction comes in the form of the spreads and in the higher interest risk they express. And in principle, it works. And so we must not simply abandon this mechanism. If we transferred the interest risk to the Community, and did not find a replacement means of ensuring that common fiscal and budgetary policy rules are observed, we would be scrapping the only mechanism contained in the Stability and Growth Pact. That is the point that – in my opinion – is sometimes overseen when the discussion fails to scratch beneath the surface. Besides, I firmly believe that it would be a disastrous signal to send to the financial markets. They would immediately interpret it as meaning the euro would now cease to be a stable currency. So we need to take the discussion a little deeper and go about it with a little more care and attention.

However, this mechanism cannot protect other euro zone members from the risk of contagion arising from a loss of confidence in the euro on the financial markets. For this reason, we have laid foundations for the <u>medium term</u>, in the form of the decisions adopted by the European Council in October and December last year. These go beyond short-term crisis management to pave the way for lasting stabilisation of the euro and European Monetary Union. We will reform Europe’s financial rules in key areas – the European Council has already decided that much.

First, to ensure we have a lasting solution, the system for keeping national fiscal and budgetary policies within a common framework must be made more effective. To achieve this, we will markedly toughen up budgetary and economic policy surveillance under the Stability and Growth Pact. The Pact will be given sharper teeth to prevent individual euro countries from pursuing destabilising policies. The mechanisms under the excessive deficit procedure will be set into motion sooner and according to more precise criteria. Part of the tougher surveillance will involve sanctions being imposed earlier and more quickly if rules are broken, and going a long way towards making them more or less automatic. That also applies, by the way, to the toolbox for sanctions, which will be added to in terms of the conditions for access to certain European funds.

And in future, when it comes to the initiation of an excessive deficit procedure, a euro country's level of debt will also play an important role. We will no longer sit back and watch if Member States create structural problems for themselves and undermine their own competitiveness through poor policy. Work on this is currently underway as part of the preparations for the European Council at the end of March, in the form of a pact to improve competitiveness. Whether and to what extent the rules of the European Semester will change the way budgets are prepared is a technical question, but one which very much features in the preparatory considerations.

Second, we need a new, robust crisis resolution mechanism for emergencies. No matter how much tougher we make the Stability and Growth Pact, we will never be able to completely exclude the possibility that, one day, an extreme crisis could again materialise and potentially threaten the stability of the entire euro zone. Only a robust set of tools can provide a lasting safeguard for euro zone stability. But not every crisis mechanism is equipped to do that. For one thing, the mechanism we adopt must be legally watertight. And the only way to achieve that is by making limited amendments to the EU Treaties.

It is also clear that a permanent crisis resolution mechanism not only requires solidarity among all of the euro members, but must also include a means of involving creditors if restructuring should prove necessary. The European Council set the course towards this on 17 December 2010, and the inclusion of collective action clauses in all euro-area government bonds issued from 2013 onwards will make things calculable for investors. Incidentally, this isn't entirely new territory for the financial markets. It's just something we have to introduce for the euro zone as well.

When it comes to the instrument for such a European Stabilisation Mechanism, which is supposed to supersede the existing financing facility based in Luxembourg from mid-2013 onwards – with regard to the toolbox for this mechanism, we will have to answer the question of what the independent European Central Bank's job should involve in the long run, and what it should not involve. This was a central question when European Monetary Union was founded. For us Germans, almost symbolic value was attached to the fact that the ECB was to follow the same rules as Germany's Bundesbank in being independent, autonomous, and exclusively committed to safeguarding price stability.

This contrasts with America's Federal Reserve, for example. Looking to the future, too, we must answer the question – a question of democratic theory, if you like – of which duties are to be carried out within the democratic decision-making framework, and which should be assigned to an independent central bank that does not function in terms of democratic decision-making principles, but is committed solely to monetary stability. You will not be surprised to hear that the German Government, and the German Finance Minister, will continue to advocate our firm understanding of an independent central bank's duties. Nor will it surprise you that in this clear commitment – naturally not forgetting what I said before, leading in to this – we also find the following question: What instruments shall we give to the European Stabilisation Mechanism? And in answering this, we must keep in mind the tasks that we do not want to assign to the European Central Bank on a permanent basis. Every now and again, it's time to say: Hic Rhodus, hic salta!

Third, the financial markets expect us to answer the central question, namely: where will nation-states' responsibilities lie in future, and where will the limits of these responsibilities be, particularly in budgetary and fiscal policy? There is no argument about the fact that Europe, and above all the euro zone, must improve the links between different countries' national fiscal, budgetary, economic and social policies in order to stabilise the common currency.

Because we have to respect the strict boundaries imposed by both constitutional and European law, but above all because in the vast majority of Member States, political resistance to further communitisation is at present strikingly apparent among the people, as sovereign, and reflected accordingly in the parliaments, we will only be able to make limited institutional progress in the near future. Besides, even the willingness to accept further treaty change is rather limited at the moment among most parties, after their experiences with the Lisbon Treaty. Even in the European Parliament, and in a number of Member States, the reaction to the German Government's, or the Chancellor's, demand at the European Council last March – let me put it in the words of the French President, who has a knack for coming up with neat and memorable phrases, which I think he has again proven over the last few days. He said that if the European Commission wanted to say that the price rises for raw materials have nothing to do with speculation, he would recommend publishing that report on 1 April. I think that was very well phrased, which is why I have repeated it here. His spontaneous reaction was that for the rest of his life – that is, his political life as President of the French Republic – he would never again go through a change to the Treaty. And we have to bear in mind that we are talking about a man who, unlike his rival candidates, Ségolène Royal and François Bayrou, said in the run-up to the election that he would not hold a referendum on a new treaty. And we have to be aware that if there had been a second referendum in France, we would not have succeeded with the new treaty. If we keep all of this in mind, ladies and gentlemen, then I think it is fair to say that the Chancellor achieved a great success when she managed to convince the European Council of 17 December last year to agree a limited amendment to Article 136 of the TFEU. By the way, before it happened, most commentators wrote – and you can check: there are people who keep old newspapers – that she would utterly fail to push this proposal through. She did not fail.

On the path to increased co-operation on economic and fiscal policy, we will therefore have to concentrate, in the near future, on the tools of intergovernmental co-operation – particularly the enhanced co-operation in the euro zone stipulated for the EU in Article 136. On a point of principle, this may be only the second-best solution for the development of Europe's institutions. But it is the only feasible solution for the time being. One question that arises here is to what extent parliamentary legitimacy for this exists at a national level, and also whether this parliamentary legitimacy can be complemented or replaced at the level of Europe or the euro zone.

The '17 plus' question concerning EU Member States that do not yet belong to the euro zone has been raised, namely whether these countries – our neighbour Poland, for example – could participate voluntarily in the decision-making process within the euro zone. I am very sympathetic to this idea, not least to avoid the enhanced co-operation within the euro zone developing into a permanent schism of the EU. For those of you whose memory goes back further, I would like to add that there was once a paper that caused a lot of misunderstanding about a 'core Europe'. As I know both authors quite well, I can offer the following binding interpretation, and you can read it in the paper itself: they wrote what they did at the time to take Europe forward and not to divide Europe; and the aim was always to integrate Europe as a whole.

Ladies and gentlemen,
I will say it once again: no-one wants to see a European super-state that would effectively transfer all the responsibilities of the traditional nation-states to European level. And because of that, we must stick to this European process of construction. That means striking an intelligent balance between government responsibilities at national and European level; adapting this to new developments where necessary, as in the case of systemic risks; and ensuring every decision has a legitimate democratic basis.

Against this background, enhanced co-operation between the EU's members – initially on an intergovernmental basis – is the method of choice for improving co-ordination of national financial, economic and social policies. If this is what 'economic government' means, I am in favour of quickly clarifying its boundaries and the details of how it will make decisions on an efficient, democratically legitimate basis. I am also in favour of introducing a benchmarking procedure to enable us to learn from one another in various fields of politics. The current project between France and Germany to harmonise taxation is already a good example of this.

As you know, progress sometimes comes from France and Germany working together – which can sometimes put us in a tricky situation, because if Germany and France don't lead the way together in Europe, people say that we're not doing our job. But if we do, then they say that we're trying to dominate Europe. So we always have to be a bit careful, a bit diplomatic about that. But I think we're doing quite well at the moment.

I am also in favour of taking up my French counterpart's suggestion of combining the benchmarks used to compare economic and social policy with some type of arbitration procedure. She hasn't come up with concrete details of what form the procedure should take, but it is a good thought which is worth following up and expanding on. And as I have said, it is also important to me that we do not create an exclusive club in the euro zone, but that we allow other Member States that do not yet belong to the euro zone to participate on a voluntary basis – should they so desire.

The approach I have outlined may sound disappointing at first to all those who are now calling for the supposed structural faults in European Monetary Union to be corrected once and for all by building up the political union. But it is an approach that – in my view – echoes the genesis of European integration. Europe is, and will remain, complex and complicated. Europe moves forward one step at a time. But ladies and gentlemen, for all the complication, all the strain, we can ultimately say: and yet it moves.

And if we just look at what has become possible over the last half-century, or even over the last ten years, for that matter, we see that it is always much more than we thought possible at the outset. And now to the last optimistic comment. Ultimately, crises have always carried Europe forward. I am convinced that a free society – as Popper teaches us – moves in any case by learning from mistakes and correcting mistakes. As such, crises are opportunities. That is why I am quite sure that the same will be true of Europe this time round. And that is why this new crisis surrounding the European currency has brought us to a crossroads, to the threshold of a new phase of European integration. Thank you very much.

Recently published as a contribution to this series on the future of the Euro:

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