TACITUS-LECTURE

Guildhall, City of London, 24th February 2011

Lord Mayor,

Excellencies,

My Lords, Aldermen,

Ladies and Gentlemen,

It is a great honour and a privilege to be invited to give the prestigious Tacitus Lecture in this wonderful Guildhall. As a freeman of the City of London, I feel at home.

I am very pleased to hold this lecture named after the Roman historian Publius Cornelius Tacitus - well known for his "Life of Agricola". Tacitus described Londinium as a thriving city of trade and business – so he is a good patron for this lecture of the Worshipful Company of World Traders in the City of London.

Tacitus is also renowned for his "Germania" - the first comprehensive report on the region that today is called Germany. At school, we were tormented with reading and translating the very long sentences of Tacitus in our Latin lessons.

Tacitus was quite fond of the Germans - he saw them as a kind of “noble savages” in contrast to the over-civilized Romans. In his recent book also titled “Germania”, Simon Winder characterizes Tacitus' view of the Germans as: ferocious enough to explain why the Romans could not subdue them, but savage enough to explain why this was not really worth the effort.

Germany’s role in the world economy is a broad topic. So I would like to concentrate on giving you some views on the role of international trade in our globalized world, the situation of the German economy, the future of Europe and the Euro zone.

There is an ongoing debate on all these questions – and I cannot guarantee that markets and governments do not change their views while I am speaking. So please shut down your smart-phones and do not stir up markets. I will speak to you as a humble observer of the scene – not as an actor in the play.

LADIES and GENTLEMEN,

Trade is beneficial

If we open up more, it will be more beneficial.

We believe, it is the best means to increase prosperity for all. Basically, David Ricardo's theory of comparative advantage is as fundamental as it was in the 19th century. This has been challenged. Bismarck once said: “Free trade is the natural way for a dominant power to fortify its position”.

However, today, Germany and Britain are champions of free trade.

In the last two decades, global trade has developed at an incredible pace, growing faster than overall GDP. Trade as a percentage of global GDP has never sunk below 40 %, and sometimes it has reached over 55 % of our economic activity. Trade has been more liberalized than ever, and tariffs have gone down dramatically.

Free global trade needs global rules. The WTO, the World Trade Organisation, has been very successful. It gives a framework for best practises and best conditions for trade. But we have to do more.

We have to bring the Doha Round to a successful end

The OECD has calculated that:

• the gains of full tariff liberalization for industrial and agricultural goods could amount to nearly 100 billion US dollars in terms of increased economic activity

• benefits of liberalizing trade in services could even reach 500 billion US dollars

• a Doha agreement on trade facilitation could contribute another 100 billion US dollars

But the negotiations of the Doha Round are stalled. As in all negotiations, the balance is difficult to strike - blockades make compromise difficult - we need political will to overcome the difficulties. But we are convinced that all countries will profit from the results of the Doha Round.

Prime Minister David Cameron and Federal Chancellor Angela Merkel, together with the President of Indonesia and the Prime Minister of Turkey, have asked Peter Sutherland and Jagdish Bhagwati to form a group of experts to work out a way to accelerate the overdue solution of the remaining problems. An interim report was presented on January 11th. We are looking forward to seeing the final version in spring 2011.

If the Doha Round does not progress this year, the global trade system is in danger. We are already observing an increase in bilateral and regional arrangements. Germany and the UK need free world trade - so let us do everything to bring the Doha Round to a successful conclusion this year!

What about Imbalances in World Trade?

A lot of myths and misunderstandings can be read about this. Bilateral trade balances provide no useful information in a global multilateral trading system.

Certainly, it is advisable that countries look after their own trade and payments balance with the rest of the world.

Imbalances inside the same monetary union are fundamentally different from imbalances between countries, where exchange rates **can** be used and **are** used to manipulate trade flows. It is absolutely absurd to put Germany and China in the same basket. If there is a meaningful balance, it is the one between the Euro zone and the outside world.

Here I have good news for you: The Euro zone has a very stable trade balance with the outside world. Since the creation of the Euro, it has remained within about 1,5 % of equilibrium. German exports compensated for more imports by others.

LADIES and GENTLEMEN,

Trade has to do with Politics

Trade does not happen in a separate territory like in a vacuum. It takes place in a world of conflict, of dangers and risks. So Traders need to observe foreign and security policy very closely.

Trade needs security and international security has a direct impact on trade. Piracy has become a real problem. 90 % of global trade goes over the sea. Certainly, the main problem has to be resolved on land, but all sea-faring nations should be aware of this problem and join the campaign against piracy.

Terrorism has not only had innocent victims, it is also making trade more costly. Security does not come free of cost. So traders have a profound interest in fighting against terrorism.

At the Munich Security Conference this month, Foreign Secretary William Hague made a great speech on cyber security.

Our societies and economies are very vulnerable against cyber attacks and often unaware of the threat. This is a challenge not only for states, but even more for private companies. Modern services need information technology, and IT security is crucial for these services.

Wars and internal conflicts can disrupt trade. Germany and the UK share the same views on most topics on the international agenda - be it the Middle East Conflict, the war in Afghanistan, be it the many conflicts on the African continent or the Korean peninsula.

In our interconnected world, no single state can shoulder all this alone. Not even the United States can. In this sense, a sovereign national foreign policy has been rendered obsolete by globalisation – it belongs to yesterday. If European states want to shape globalisation in a way that suits our values and our interests, we have to pool our sovereignty and act together through the Common Foreign and Security Policy of the European Union.

Trade negotiations can only be successful if we can put enough weight behind it. Some years ago, the US was tempted to impose steel quotas on European producers to protect the American Market from unwanted competition. There was no single country, not Britain, not Germany, that could have challenged this decision.

Only the EU Commission with all its weight and the exclusive competence to act on behalf of the Union in all trade matters could do this and did it successfully.

If we negotiate with China on intellectual property rights or with Russia on energy supplies, in all cases we will only be strong enough with a common approach.

The international world is not only conflict and risk. Globalization is above all a great opportunity. Trade is no zero-sum game. Rather, it will make everybody more prosperous. Traders have always been traders of ideas and of lifestyles. If we observe now how the ideas of freedom and democracy are conquering the Arab world, we should see this as an opportunity and help the people to use this freedom with responsibility.

Another opportunity is the rise of China and India, of Brazil and South Africa - a prosperous China will always be a potent trading partner for us, and new markets can bring wealth to us all.

International Trade needs international financial markets.

Both have become more and more global during the last decades. Financial markets have changed fundamentally through technical progress and financial innovation.

I have always liked the image that the production of goods and services is the motor of the economy, and finance is the grease making the motor go smoothly. However, if there is too much grease, the motor can be severely damaged.

In the last decade, there was too much grease in the form of too much deregulation and lack of supervision. Sometimes you hear that we cannot predict or prevent crises, but just have to accept them. This is highly dangerous, because it leads to inactivity where active prevention is necessary.

A Geophysicist can perfectly predict **that** an earthquake will happen, the only problem is you never know exactly **when**.

But this is no reason to believe that, what has not happened for some time will never happen; this is no reason to stop enforcing strict rules on the construction of buildings in earthquake zones, and this is no reason for insurers to give up their very careful study of risk in such zones.

The same is true for financial markets. Prevention is vital. In the run-up to the recent near-melt-down of the markets, most actors underestimated the correlation of risks and the systemic risk involved. So we have a duty to prevent further damage and avoid making the same mistakes twice.

We are still on our way out of the economic and financial crisis. The loss of confidence inside the financial markets has not yet been overcome. Most of us are now out of the deep recession, but still not at the level before the crisis.

To prevent the next disaster, we have to increase market transparency, we should not tolerate off-balance-sheet operations in any sector. We must deal with the tax-havens and regulatory havens which have undermined the institutional stability of the financial system.

It was unfair to blame only the regulated banking sector. Their risks just became visible first, and it was their rules that forced intervention when the situation became untenable. But the fact that an important part of the market was invisible does not mean that is was not creating similar systemic risks.

And we still need a closer look into wrong incentive structures leading to short-termism and risky behaviour. It must be profoundly in the interest of the financial sector itself to reduce the inherent instabilities and to regain the trust and confidence of the public.

Trust is absolutely crucial for all human relations, for social as well as for business relations. And at the heart of the financial crisis lies the breakdown of that trust. We all know what it means.

LADIES and GENTLEMEN,

A worldwide crisis needs a global response

The crisis has changed the global framework. The G7 are no longer sufficiently representative to tackle global problems, as the 5 permanent members of the Security Council do no longer reflect the world of today. New powerful players have emerged in the world economy.

China, India, Brazil and South Africa have become economic powers, the Gulf States or China with their Sovereign Wealth Funds have become leading financial actors.

The G20 represents 85 % of the world economy. Their decisions on financial market reform, stricter capital requirements for banks, responsible remuneration practices in the financial sector are essential for creating a level playing field.

The G20 summit in London in April 2009 was a milestone in giving a swift and comprehensive first-aid-response to the crisis. Now the G20 have to prove that they are not only representative, but also efficient.

Our voice in the G20 has diminished compared to the G8 - therefore we need to pool our voice more than before in speaking with the one voice of the European Union.

To be taken seriously, Germany needs Europe and Britain needs Europe.

What about Germany, LADIES and GENTLEMEN?

Have you heard about the new "Wirtschaftswunder"?

I come here to bring you good news: The German economy is in good shape. Growth in 2010 was 3,6 % - much more than anybody expected. At 6,8 %, unemployment is the lowest for the last 20 years. I should feel very comfortable when I am asked about the new German "Wirtschaftswunder".

But I do not come here to bring you the gospel. The German model is not easily transferable because of our specific background. I cannot but add a dose of caution.

In a drama, protagonists are usually put on the highest pedestal only to fall deeper when the fifth act comes. So here is my word of caution:

First of all we had some bungee-effects: during the crisis exports fell sharply, so it is no wonder that they rebounded - especially if deferred orders are now coming in.

Secondly, the German recovery strongly depends on the recovery of our main partners. This explains our keen interest that the UK, as one of our most important trade and investment partners, is recovering and flourishing.

But do not get me wrong: There are strong reasons to be optimistic about the sustainability of the German recovery.

Before the crisis, we had a balanced budget. While the German contribution to the deficit spending in response to the crisis went up to around 4,5 % of GDP - among the highest in the OECD countries – Germany also started very early on to steer away from deficit spending back towards a sound budget.

Germany did not have an asset bubble! House prices in Germany have remained stable for around 20 years. Nobody was offered 100 % mortgages or more, so private debt is much lower than in many other countries including the UK.

The reforms of the Schröder-Government - later continued under the Grand Coalition and the actual government – have had positive effects on German competitiveness.

Some commentators recommended that Germans should become less competitive, spend more, work less and export less.

I find this rather astonishing, especially as only 10 years ago, commentators were battering us for being sclerotic and not really competitive.

So we are no "Wunderkinder"! What we see is the result of a combination of keeping some sober traditions, implementing painful reforms, rewarding responsible behaviour and having a good institutional framework.

Where will we go?

Germany will continue to be an exporting nation. There is a lot of demand for German manufactured goods all over the world. We cannot always compete on price - but are unbeaten in quality. Our wealth is our human capital.

Vocational training is one of the reasons for Germany’s economic success. In the current demographic situation, we cannot afford to waste talent.

It is important to bring out every single person’s potential by giving access to world-class universities as well as an efficient system of vocational training.

Research and Development is another field for nurturing success. With the excellence initiative to promote competition among our best universities and with institutions like the Max-Planck-Institutes for high level research and the Fraunhofer Institutes for bringing innovation into production, we are trying to keep the competitive edge.

The growth of the German economy last year was bolstered by exports particularly in the first six months. But then the situation changed.

Over the year, only 30 % of growth was due to exports, 70 % of growth came from the domestic market - some of that from increased consumption, but the greatest part from domestic investment in goods and services.

This shows a great confidence in the future of the German economy.

When the reforms in Germany were criticized some years ago, I always insisted: We are not just repairing our economy – we are preparing it to challenge the future.

Germany is preparing for the future - and we see manufacturing as still having a bright future in Germany.

Manufacturing still accounts for nearly 25 % of German GDP, which is more than twice the figure for the UK. This is only sustainable if companies remain at the forefront of technological progress. Our manufacturing sector is highly capital and research intensive.

As in all advanced economies, we will also have a greater role for services in the economy. But services need somebody to serve, so services in Germany grow together with the customers being served.

Services in Germany have become much better in the last years, but there is still some way to go. Germans are not willing to pay much for services - and before accepting bad quality service, they tend to do it themselves. But we expect fast growing demand for all services, especially in the care and health sectors.

LADIES and GENTLEMEN,

A peculiarity of the German economy is the strong position of small and medium enterprises, theSMEs. Many of them are family businesses, some world leaders in their market. The combination of big and strong global companies with very flexible and innovative small and medium businesses will continue to be a special feature of the German economy.

Both - big and small - are very strongly based on research - a company like Bosch develops some 15 patents a day. So you can imagine that in Germany, the social prestige of an engineer is rather high, higher than any lawyer or banker, not to mention diplomats or politicians could claim. But there is a weak point here: a shortfall of thousands of engineers - if you leave university in Germany with an engineering degree, your job is secured.

Labour law and a tradition in labour relations inspiring loyalty between employer and employees has helped Germany's economy. There is no tradition of rapid hire and fire. Companies have retained their skilled labour because they see it as a valuable resource.

This was possible thanks to short-time working allowances paid by the state and even more by in-house agreements on flexible working hours and temporary wage reductions.

As a result, when demand started to rise again, German companies were ready. German success is no godsend, competitiveness has been earned by years of wage restraint and structural reforms.

The German Financial Sector is functioning

The German 3 tier banking system - while affected by the crisis - has proven resilient against drying up of credit. Banks in Germany have a close link to local business, many lending decisions for small and medium businesses are made locally, not referred to remote headquarters. The local savings bank or the local branch of commercial banks know their SME customers in every detail, so they know where to put their trust.

A public bank, the KfW, played an important role in tackling the crisis, providing venture capital for research projects and serving as an agency implementing government-funded support measures, for example financing energy efficiency programmes.

Big finance in Germany is part of the global financial system - by the way with very strong links to London - and as you will have noticed - also to New York. Some banks are still struggling with toxic stuff on their books. The government has developed a scheme enabling banks to return to normal business while giving them time to sort out how to handle the problematic assets.

The banking and financial sector needs reform. We prefer this to happen at a global and a European level, if necessary also at a national level. We want an international agreement on a financial transaction tax, because one of the problems we may face in the future will be the growing risk of instability, if the velocity of transactions gets out of control. As a first step, a Financial Transaction Tax could be introduced in the EU. France and several other member states support this idea.

Will Germany become too strong?

Suspicions might grow with German economic success and increasing demand for German leadership in Europe.

However, it would be rather contradictory first to ask Germans to be the locomotive of Europe and then ask them not to build up steam and not to leave the station. I really hope that in the end, all the wagons stay coupled together, so that we can leave the station as a complete train.

LADIES and GENTLEMEN,

German policy today is to never go alone - we always look for partners who share our view and want to share our way forward. We continue to insist that we do **not** want a German Europe - but a European Germany. This has not changed.

And the UK is one of our most important partners - and often the partner closest to our views on the economy, even if we differ on Europe. We welcome a Britain active and activist in Europe.

The Euro lives! LADIES and GENTLEMEN,

Or should I say with Shakespeare:

Romans, Britons, countrymen,

I came to praise the Euro - not to bury it.

The German economy is benefiting greatly from participating in the European Monetary Union. All countries of the Euro zone might have fared much worse in the financial crisis without the Euro.

The Euro has proven a very stable currency. ECB President Trichet recently pointed out that in the last 12 years, the average inflation rate of the Euro has been 1,97 % - in Germany, prices in Euros have only risen by 1,5 % a year in the same period. During the 30 years preceding the creation of the Euro, the German inflation rate was higher in each decade.

The ECB has pursued a very sober policy by keeping the Euro stable, keeping inflation low and as a consequence, making possible very low interest rates.

LADIES and GENTLEMEN,

A common currency underpinning the single market makes sense: thanks to the single currency, nobody is losing time and money at bureaus de change, nobody needs costly hedging against volatile exchange rates. Trade and investment are facilitated by eliminating currency risk in this great market of 17 countries.

Price transparency enables greater competition for quality. And the Euro is also facilitating the integration of financial markets.

However, every monetary union requires mechanisms against asymmetric shocks. That is why the stability and growth pact was introduced.

And there have been misguided policies in some member states: too high public deficits, poor statistics and a legal framework incompatible with a sustainable and sound social welfare system, and even cheating partners. So we have to strengthen our mechanisms.

The international financial crisis has put great stress on several Euro zone countries. Deficit spending served to rescue the same banking system that is now nervous because of public deficits.

The sovereign debt crisis in some member states made some structural shortcomings in the institutional framework of the Euro evident.

But like the Chinese State bank, I trust our Euro zone countries' bonds more than all the toxic paper still at many of the banks.

The single market can only work if there is greater convergence between member states especially in the Euro zone. The crisis is a chance to bring this convergence forward. This is in the best interest of all member states.

I will not go into details about individual Euro zone countries. But we must not overlook that the stability of the countries of the Euro zone is very much in the interest of the other member countries of the EU inside and outside of the Monetary Union.

Britain is dependent on a sound single European market, and British banks are highly exposed to risks in some Euro zone countries.

LADIES and GENTLEMEN,

The EU has handled the crisis deftly

Following emergency assistance for Greece, a formal rescue mechanism has been set up, again subject to strict conditionality. As a core instrument behind the rescue mechanism, the European Financial Stabilisation Fund has been in place since June 2010. It has a very lean structure with only about a dozen staff. The Fund's objective is to preserve the financial stability of the Euro area by providing temporary financial assistance to Euro area Member States in difficulty.

In order to achieve its objective, the EFSF can, with the support of the German Finance Agency (Debt Management Office), issue debt instruments on the market to raise the funds needed to provide loans to countries in need.

The Fund has been assigned the highest possible rating (AAA) by all three rating agencies. Its debut bond issue in January, intended to contribute to the rescue package for Ireland, was heavily oversubscribed due to keen interest from international investors.

To be very clear, the EFSF does not issue Eurobonds, it is not a development bank and it has only a limited mandate. Markets sometimes have expectations as if this were an unlimited money machine. This is not the case and cannot be the case because of the limits of orderly budget procedures.

However, governments have proven that in case of necessity, they have the will and the power to react to all contingencies.

The German Government stands firmly behind the Euro. We will not give up the Monetary Union - all speculation in that direction is absurd. Germany profits from the Euro as do all the other members of the Euro zone.

Failure of the Euro would mean the end of the European project in its present form. This would have disastrous effects, including on member states outside the Euro zone. We count on all member states in our efforts to stabilise the countries which have difficulties. I repeat: Germany stands behind the Euro.

The long term solution is: more Europe

The EU is working on a permanent rescue mechanism to come into force when the present structure expires in 2013. Creditors will then be sharing future risks. This will encourage the sector to be more prudent.

The EU is not a sovereign state, we do not share all assets and we do not share all liabilities. For us, a liability union without responsibility for the assets is a red line, because sharing the liabilities but keeping full sovereignty on national fiscal and economic policies would just invite everybody to become a free rider.

Solidarity is not expressed through using the currency to cross-subsidize fiscal adventures. Solidarity is expressed for example through regional funds helping countries which are still below the average income to catch up with the other member states.

The European President, Mr. van Rompuy, will prepare proposals for a more competitive Euro zone. He has a mandate to finalize this by the European summit in March. Making all member states more competitive will also enable them to generate the growth necessary to get out of excessive debt.

This is in the best enlightened interest of all countries. I admit, not everybody seems so enlightened that there was immediate enthusiasm. And we expect fierce debates on the details of how to enhance competitiveness.

However some minimum standards are necessary. We do not expect every country to have the same taxes, but it would help business very much if we had a single transparent system for calculating the tax base. We may have different social systems, but it would split the union if some members get the impression that they are subsidizing excessive budget deficits and privileged welfare benefits for other members, while asking austerity of their own citizens.

As is well known, Germany does not like inflation – so we stick to a stable Euro. By the way, King Henry the 1st of England was one of the first fierce fighters against deterioration of the value of money. When complaints abounded that silver coins had less and less silver content, he summoned the moneyers on Christmas 1125 and let them cut off the right hand. What else he ordered to be cut off, I do not say out of respect for the audience. Only to say that German ideas about sanctions in a new stability mechanism are comparably mild.

Never waste a good crisis - there is a lot of truth in this saying. I am convinced that the Euro zone, and with it the European Union, will emerge with a strengthened currency in a stronger union.

LADIES and GENTLEMEN,

The European integration after World War II has been a success story unprecedented in European History

Peace, prosperity, individual liberties and democratic stability are the ingredients of this success story.

Today, the single market unites 500 million people without any barriers for trade and investment, with freedom of movement and no customs officer turning your luggage upside down. This is a great achievement, and we should not underestimate it.

In particular here, in the City of London, I hope more people will speak up for the EU and European integration. Banks and other providers of financial services depend on worldwide free trade and open markets. Europe helps to guarantee a level playing field and access to markets, as well as sensible regulation of financial services.

Europe needs Britain and its economy as a contributor to its political clout, its competitiveness and its economic strength as much as Britain needs Europe, if it aspires to remain among the global players.

LADIES and GENTLEMEN,

Germany and the United Kingdom are closer than ever

British-German relations are excellent. To make Europe fit for the new challenges is paramount among our common interests.

The UK and Germany are inextricably bound together by history, shared interests and common values. Ours is a rock-solid friendship and partnership. Our national identities will last, but in addition to that, we are also fellow Europeans and citizens of our common global village. London as a global city located in Europe and rooted in Britain is the appropriate place to stress these dimensions of our well-being.

In this spirit, I will finally mention the war. 70 years after the Blitz and the destruction of Coventry, I was very moved to hear Benjamin Britten's requiem at Coventry Cathedral and later at Westminster Cathedral performed by the Parliament Choir with the participation of the German Choir in London. We must remember the bleakest period in order not to repeat it.

However, German-British relations encompass a rich history of centuries of mutual influence and many exchanges. It is the common European project which has made it possible to overcome the past, and engage in a common future.

German-British relations have a great future!