

KÖNIGSWINTER

The British-German Conference

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SIXTH ANNUAL ECONOMIC KÖNIGSWINTER CONFERENCE

Friday 11th November – Saturday 12th November 2005.

Ditchley Park, Enstone, Chipping Norton

Oxfordshire OX7 4ER

'Globalisation and the Challenge of Competitiveness'

Chairman: Sir Alan Budd, D.Phil. Provost of the Queen's College, Oxford.

The advantages of an annual bilateral Conference are that one may be able to gauge if the respective nations, even if represented by different participants each year, have similar or differing reactions to common problems over time. Perhaps we can also hope that we may find some answers to a number of broad questions and measure the mood of the decision makers from year to year.

Reading through the notes made during the Conference, it is sometimes hard to tell if a German or a British contributor has made the point. On other matters such as culture and manufacturing there are some clear differences. Even the tone of the British participants is less optimistic than in past years – the slowing of growth, the increase in taxation and regulation did not permit more than an occasional exhortation to the Germans to buy more houses and revive the consumer. On the otherhand some German glimmers could be spotted (occasionally), not least when it became clear that Germany might again have an agreement to form a Government before the Conference finished.

One clear theme running through both days was the emphasis by both Groups on the Nation State, rather than expecting any solutions coming from Brussels. Indeed 'Brussels' may be one of the problems, either through an extra overlay of further regulation or the rules of the Stability and Growth Pact, not a solution. Though some problems such as trade and energy policy were needed to be tackled at the EU level, most others needed to be approached nationally. There were worried references that the current trade round might not work and how damaging this would be for all countries. Besides trade was not a 'zero sum game' and the dependence on the EU for getting a solution was not felt to be guaranteed. The EU had been slow at introducing liberalisation of the energy market, which could have had a much more powerful impact on industry's costs; a failure to introduce reciprocity in cross border takeovers. Blair was in danger of being a 'Two Speech President' of Europe: bright speeches and no action; not a wrecker certainly, but not a reformer either.

Nowhere in the discussions did a 'new Agenda' seem to emerge, bemoaned one British participant. Lisbon was defunct, there was no Constitution. Enlargement had succeeded but how far could that go? Where the French had once wanted the leadership of the EU, now they showed no inclination and no one else was assuming that mantle. The question was why?

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The failure of the EU had been to assume that with the right institutions the policies would follow rather than the reverse. Now without a constitution even this assumption had gone. All attempts to build had missed the opportunity to create a framework for strong economies, and there has been no domestic advantage to see a 'European Way'. But to business leaders Europe was far wider than the EU. Businesses were defining their own boundaries, and this was positive. Europe also seemed to show various national models for growth, some working better than others. A Rhineland versus Anglo-Saxon view seemed too simplistic and sterile. Either way the rate of growth in Europe had slowed, unemployment levels had risen and stuck, productivity had declined (which measurement?). Per capita Europe was behind the US but not per hour, the Europeans just worked less for differing reasons. Back to national solutions and politics.

A second theme was a lack of clear leadership at various levels. For instance this was at the national level in Germany (even perhaps with a new Government that could have problems in the marriage of 'convenience' rather than 'love'), with the failure of a political elite to be bolder in 'selling' a reform agenda to the country. The tone of the German government was too paternalistic, gloomy, inconsistent and inward looking said one German participant. Here this was put down to national mindset as much as the Federal structure. It was 'amazing', said one British participant that Germany could indeed still function so well for so long without a Government at all. It was not surprising though, since the German politicians were isolated from the electorate. In their defense said one politician, they were shielded from the daily political pressures like constituency letters, the intrusions of the press. The German system worked in a different way.

Governments indeed were the problem not the solution came one British voice. Where they had meddled in economic growth, nothing but costs, distorted markets and failure had arisen – biotech development and investment schemes to name but two. The political class were afraid of speaking the truth to the electorate, said one German politician. The business community could do far more to assist public policy, using its expertise. Often also to educate the politicians on matters of business to avoid the 'locust' polemic. This was a cross country plea.

If the German Government was slow to reform, then there was also the failure of the business classes to talk to 'civil society', their workforce and unions. These were thought, through personal experience, to be far more adaptable and flexible than given credit for. A British delegate thought there was an absence of leadership everywhere, and a resulting inability to diagnose the economic problems in Europe. But how could German business reform unless the politicians made some better rules? Indeed were German corporations really doing so well, or merely that they were exporting jobs, and keeping wages flat over the past 5 years – no wonder the consumer felt reluctant to open his wallet. Certainly not all German companies were flourishing, that was too broadbrush. Look at Volkswagen, Daimler and Deutsche Telekom. Layoffs were rife, and low pay was not showing any return for the employees.

Here the interaction between business and government was failing, said one senior manager. Berlin was not encouraging the entrepreneurs with its talk of wealth taxes, 'excessive' executive pay, the trial of one of Germany's foremost bankers and overall envy. There had been no lead about reform of the public sector: a theme which was also close to the heart of many British participants.

Germany still felt like the Britain of the 1970s, said the British who were the past masters at 'managing decline'. The political change for Britain came only in 1979, and then she had reached rock bottom. Indeed how could Schroeder succeed when he had not been preceded by a Thatcher revolution? Blair was only possible after Thatcher. Schroeder had had no predecessor like her, though he had tried to be more radical than he had been given credit for, a thought that came from the source of an unlikely British politician. If there had been a failure to find a 'Neue Mitte' for Schroeder and Blair (even the translation into English pointed out differences of expectation), then just how likely was a Brown – Merkel pact to emerge? Even a Franco-German alliance was unlikely.

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But British elites also did not escape unscathed. A British comment was that companies needed to push Brussels and drive the reform for open markets in sectors like energy. Or who should push for more united capital markets (where there too many inefficient local markets, with many local sets of regulations and regulators); the EU, said a business man. Then why had the investors hindered the merger of the Deutsche Boerse with the LSE said one regulator? Charlie McCreevy had challenged business as to which regulations the EU should repeal, so far the business community had failed to take up his offer. Often business did not help itself enough. It was also reluctant to invest despite economic stability.

The UK suffered traditionally from low human capital, a legacy it found hard to shake and only relieved by the possibility of very low entry jobs from a flexible labour market. Getting a job was better than none at all. That might be alright while services hadn't been exposed to globalisation, but this could change. More emphasis on education would then be needed or the UK would feel the problems the Continent already had from globalisation with its manufacturing sector. Labour market reforms in the UK had been long and painful to achieve, should be guarded against EU interference and were easily lost. The Germans complained about the poor British infrastructure, a meeting in the UK could never start on time as workers were always delayed in arrival.

But the British government sector was a growing portion of the economy, the productivity of the public sector was shrinking, and all the increase in spending and overhead paid for by the private sector, noted one businessman, showed only a steep decline in output. The UK had made progress in growth after the ERM crisis but this had reversed over the last 2 or 3 years.

In an audience of senior people it was inevitable that the question of ageing societies should emerge. Be it the overhang for both countries of the rising and impossible cost of civil service pensions, or the under-utilisation of an aging population. Germany and Britain would have to work longer than the current retirement ages of between 55-60. Germany still had the youngest pensioners and the oldest students. Employers could be ageist, and ignored the depth of experience. Aged societies had more savings. Youth may be more vigorous but it offered different qualities. Cezanne had painted his best pictures in old age, Picasso in youth. Germany could also make better use of its female population and bring them into the workforce, the UK had more senior women than Germany.

Immigration was also an issue as this was a problem across Europe. How could immigrant societies be better integrated? In the USA they had been made to learn English, become Americans and do better than their parents. Immigrants could not just stick with low paid jobs but would also need education reminded some. Europe was also an ever smaller part of the world economy and population. 30 years ago Europe had been 30% of the world's population, today it was only a stagnating 7%. Lack of growth would make integration harder. And how could Europe defend and close its borders against north Africa and Asia? The Europeans would have to work harder, this was how the Germans had rebuilt themselves after the war: hard work and better products. But should the Germans be encouraged to spend their hard won savings at home or did it matter if they preferred imports? Surely a more autarkic route was not an answer as even imported goods needed domestic sales and distribution networks that provided domestic jobs?

But were the Europeans alone with this gloomy prospect, surely the Chinese had their own problems and an ageing society?

The final Session was devoted to the theme of regulation. But this had been a current running throughout the Conference. Generally regulation should be suited to respective national cultures. The Americans were the 'cowboys' and needed strong fences or tough legal frameworks. The British were more gentlemanly in approach and needed the ethical codes of a club. The FSA was an American style reaction to a British problem. The French of course needed laws but treated them like codes. An EU overlay was overkill. Indeed the EU was too weak to deregulate. Regulation could not be used at an EU level as an alternative to policy,

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we would condemn ourselves to overregulation, again this had to be decided at a national level. One size may not fit all, but then business would complain about the fragmentation of markets and lack of a level playing field.

Too much regulation would be deadly, it was currently costing the EU about Euro 46 billion a year said one banker; but where was 'proportionate and moderate' the Group did not define. It was felt to be damaging to regulate risk out of society, it would do away with enterprise and lower returns. In any event if people were made too 'safe' and risk free they would find other means of seeking risk, the reckless Volvo driver, white water rafting. Humans have an appetite for risk and would adjust behaviour to seek it out anyway. A framework of property rights was certainly needed to protect business, but again too much regulation could be an excuse for protectionism by big business internally and externally as a barrier to trade. German and British bankers and business participants disagreed if the German banking market was too regulated or provided good and cheap enough access to capital.

UK regulators had also attempted to measure the costs of regulation and could agree with Euro 46 billion. But their view had been to try to have impact assessments and simplify rules, and take one rule away if one new regulation was introduced. The cumulative effects of regulation was damaging as were unintended consequences. Kneejerk reactions from the public or the media had to be avoided. Governments needed to be able to trust market forces. But as one participant pointed out business interest were not the same as economic ones. The benefits of the lack of regulation could be seen in the flourishing of the hedge fund industry. Business needed to be much more active in assessment of the costs of regulation and compliance. Government and regulators would listen if business made a better case. Annual reports could be used as a vehicle for this.

The challenges facing the two countries continue to be similar. Some of the reactions however are different. Overall some cultural and social differences were noted. Germans for instance, would not have their shoes cleaned in public, German beggars went on holiday. The British seemed to have classes. The political structures differed. The Federal system that had worked so well was blamed for political stagnation and the distance of the political elite. There was much discussion about national solutions but none at all about the Euro and the omission of the UK to introduce it. Even the Constitution did not rate more than a passing mention.

Policy conclusions included a better educated labour force for the UK, more manufacturing for the Germans, more Venture Capital, less government spending, less short termism and less intensive energy use, less regulation, more innovation, better trade and funded pension schemes. The Germans agreed they needed more confidence, more consumer spending (a housing boom was a mixed virtue), though possibly not devoting all this to imports, and a more flexible labour market. Both business and political elites had to make more of an effort. Regulation was protectionism in disguise. People were ready for risk. The influence of the EU on public policy seemed more restricted to European issues like trade and energy policy, especially when such large economic problems needed national solutions. A long list of agreed problems and some agreed solutions, many across the two countries, but perhaps one sensed a hesitancy towards implementation. And while there was an agreement that the challenges of demography, immigration and globalisation would grow, the domestic elites would still continue to debate what 'the Agenda' was and who should lead our way out either nationally or internationally.

Jackie Newbury
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