



**XXVI ATLANTIK -BRUECKE - CANADIAN CONFERENCE
Berlin, November 6-8, 2011**

This conference was held at the beautiful Canadian Embassy, Berlin. My report has been delayed due to travel and client obligations, but is still (I hope) relevant. The three main topics were the budget crises, information technology and foreign and security policy. Of course, the budget crises dominated and still dominates.

SUMMARY

1 - BUDGET CRISES

The untold, undebated story is the automatic 650 billion (and counting) Euro flow from the North to the South through the European Central Bank. 100 billion Euros have flowed to Italy alone since June. [This was the most important point of the conference.]

EU integration has always been a two-step process, with the first step financial and the second political, including control of national budgets. The second step did not move ahead and we are seeing the consequences.

There is no single solution to the financial problem. It will take 6+ years to deal with and will be a mix of transfers, haircuts and inflation. Changing the Greek economy may take decades.

EU member states ignore a key benefit of the integration process - 60+ years of peace. Furthermore, the DM would price German products out of the market. But German elites, including large, private companies, are not solidly behind the Euro.

The crisis will have effects on the international security structure.

2 - INFORMATION TECHNOLOGY

IT is the 3rd industrial revolution and a good fit for Germany, with its highly educated population and few natural resources. But the German educational system is not providing enough engineers. Society also sets up roadblocks, such as the slow decision-making process on many levels and the heavy stigma of bankruptcy. Germany needs to be able to attract more highly qualified people from other countries and integrate them.

The IT protection system is inefficient and cooperation between development partners is difficult due to questions of ownership.

3 - FOREIGN AND SECURITY POLICY

Security is not simply a matter of foreign military threats. "Security" is a much broader concept and should be measured differently than is currently done. Energy policy is part of security policy. Germany has just now changed its energy policy quite radically.

Turkey and the Arab countries are changing their roles. The EU has lost its influence over Turkey. The EU should help the Arab countries by encouraging agricultural and other exports to the EU.

The German vote on Libya will have negative effects on German-US and EU relations. This was a mistake by both Merkel and Westerwelle. (Both the Germans and Canadians were critical.)

The changing economic situation changes defense capabilities and policies. The US and Canada both turn more towards the Pacific. Middle powers will play a bigger role, for example in the Mediterranean.

German strategic discussions are based on US intelligence and Department of Defense reports. The German military needs to develop its own intelligence to be taken seriously.

Canada seems to think that by having survived the 2007-2008 financial crisis so well - for which it does deserve credit - it does not have to worry about the current one.

DETAILED PRESENTATIONS AND DISCUSSION

TOPIC 1 - BUDGET CRISES

Dr. THOMAS MAYER, Chief Economist, Deutsche Bank AG

Thanks to easy credit, Greece, Italy, Portugal, Spain and Ireland (an honorary Mediterranean country) lost control of costs. France did too, to a lesser degree. Germany managed to control costs until 2008-9, when German costs also went up. German labor costs actually dropped. Germany's current account went from a deficit in 1999 to a positive position in 2001 and it has remained positive since that turning point.

So, the current debt crisis is the consequence of cheap credit. The *visible* part of the crisis is the debt/banking crisis. But this is only the tip of the iceberg. The bigger problem is the internal exchange rate within the EU - a product of trade within regions. It is financed by the ECB and it has gone way up to the PIIGS [not a term Dr. Mayer used]. They account for 25% of the Euro zone economy. In 2007 they took an equivalent portion of loans from the ECB. But now they take 75% of total ECB credit. The private banking system stopped funding these transfers and the ECB stepped in. The Bundesbank has claims against the Euro system which have gone way up since 2007.

As we all know, countries in the Euro zone cannot simply devalue their currency. So there is an automatic shifting from plus to minus countries. This is not a current political decision. The Bundesbank provides this funding without any political input or direction. It presently has claims totaling \$450 billion, mainly against the PIIGS. The total of all lender countries in the Euro zone is \$650 billion. This transfer is hidden and not part of the current political discussion. Italy's problem is particularly acute due to the speed of its increase. It has gone up \$100 billion since June. [There was an audible gasp from the audience.]

So, what are the solutions? This is a balance of payments problem. How do we make this problem visible, so it can be dealt with? The PIIGS used the credits to import goods. How can the North get these funds back? There is no political will to treat it as a long-term loan. So how do we realign the exchange rate? How do we change prices so the PIIGS earn more?

One solution is to deflate prices for goods and assets so that foreigners will buy more. But this is painful and creates bankruptcies since the assets decrease in value, but debts do not.

Another solution is to inflate the problem away, keeping prices low in the South. To do this, the South has to "get its hands on the ECB." This seems to be the more likely result.

The funds flow to the South as follows: German banks put money in the ECB and it, in turn, loans the funds to commercial banks in the South. Thus, the funds do not flow directly.

There is no one "fix it all" solution, such as creating a Euro North Zone. The solution will be one of some transfers, some country drop out, some inflation and some deflation. Actual withdrawal is for the first time on the table.

This problem will go on for years. The thrust of the presentation is the hidden (and growing) \$650 billion, which is not yet even discussed.

The countries have to understand what is at stake. The ECB cannot stay out of the crisis; it is already in it. If inflation is part of the solution, how do we control it? Transfers in the US and Canada are different from those in the EU. More EU transfers will be needed.

Inflation has a time lag. It is hard to find and trace its causes. So, politicians like inflation because they are not tied directly to it. The Greek problem could be solved by "brutal" deflation, but Italy is too big for this to work there.

Looking for historical parallels, the US also suffered birth pains in the 19th century. States deflated their currency then. Ultimately there was a civil war [!]. So, integration of economies is not easy.

This is not a Greek crisis but a much more basic issue: how does the South compete with the North without devaluations?

Q+A - Josef Ackermann says the South will simply never be competitive. Is a new Marshall Plan possible? Also, the problem is not "simply" a matter of undoing the last 10 years. The BRIC countries are coming on line and so competition and the market are becoming more difficult than 10 years ago.

A Marshall Plan will not work. Germany after WWII had a lot of unutilized resources. The Marshall Plan provided an outside impulse to create exports. It was just an ignition. But the South is like East Germany. The West thought the East would become an industrial powerhouse like it was before WWII. Greece will not come back in 5 years. Perhaps in 10-20. So this is a much tougher situation than the Marshall Plan. [People also forget that France, England and other countries participated in the Marshall Plan and have much less to show for it. Only Germany - the great success - is remembered and constantly touted.]

The ECB will create a weaker Euro. Big exports will pick up to China. At first Germany will like this result. But a weak exchange rate is "a subsidy for incompetence."

There is too much emphasis on funding. Why should China participate? What's in it for them? Europe has the money, but not the will.

GLENN CAMPBELL, Director, International Policy and Analysis Division, Canada Department of Finance.

Normally banks handle sovereign risk, but the 2008 financial crisis eliminated their cushions. So countries themselves backstop the banks. Also household debt has risen. The banks have not yet written down their debt sufficiently.

This is a Euro zone problem [not directly affecting Canada]. To the Canadians, it is an issue of trade and general confidence. It does have indirect effects on Canada. If Greece defaults, is there an adequate capital cushion? What are the contagion risks? Is this a liquidity problem or a solvency problem? If just liquidity, then the problem can be solved, and the ECB handles it. If it is a solvency issue [which it is], then it requires restructuring and the IMF.

Canada is doing well and is not exposed. But it is vulnerable to macroeconomic issues. It depends on Asia and the US. The crisis affects commodity prices and currency. Asian countries are also vulnerable.

DR. JOERG ROCHOLL, President, European School of Management and Technology.

Looking back at the history of and roots of this crisis, how did this happen? Some countries did not deal with their debt issues following the Maastricht criteria. The lack of competitiveness between countries was not addressed. Also private debt was ignored, as was real estate. So, Spain DID follow the official guidelines. Its problem is the result of private debt, not public. Also, some countries did not follow the guidelines and did not face sanctions. Germany itself set a bad example. It violated the guidelines and paid no price.

The system did not deal adequately with what happens to lenders when debtors default. How do we bail out the debtors but maintain the moral hazard? The fear of contagion has won out over moral hazard in all cases except Lehmann Brothers.

Finally, the key question is not Greece but Italy. Italy is too big to be saved. It has to solve itself.

FRIEDRICH MERZ, Chairman, Atlantik-Bruecke

A "solution" involving Greece's leaving the Euro would not be good because it could have a contagion effect and that could harm the world's economy.

A major goal of the Euro was to have a stable currency and the Euro has been stable. The mechanism of the Euro was well executed. But the second step was to be a political aspect. This part of the process failed. The cure is not *less* European integration but *more*. The member states need to control money before the money is spent. In 2002 Germany itself violated the stability rules. More power, not less, should be transferred to Brussels. But will national parliaments transfer power to Brussels regarding their budgets? Competitiveness is also an issue. Spending in the south has been too high. The GDP in

Greece increased 22% but net income increased 82% over the same period. Public sector income increased 120%! So Greece needs to cut salaries and improve its industry. Democratic parliaments can make only marginal changes. For example, Germany's Program 2010 was a big deal in Germany despite involving relatively small amounts.

Countries that have gone through defaults have seen: 1) domestic reforms, with relatively small effects; 2) haircuts for their creditors; and 3) major devaluations.

So can the EU regain competitiveness in the South? The Greek textile industry moved to Turkey as a result of the introduction of the Euro. Greece cannot devalue its currency without leaving the EU. Could there be a suspension of membership? There are no rules for this, no model. There is no clear way to leave the monetary union and then reenter.

Q+A

Canada went through its own budgetary crisis in 1995-96.

The Europeans wanted a weak EU commission and it got it. Then the EU grew too fast.

The EU requires more centralized authority, but to accomplish this there has to be a strong leader. How can you convince people to commit? The South was committed because it was the net beneficiary. But will the North continue to pay? So the real threat is from the North.

Campbell - There is a stabilizing mechanism: the rating agencies. Earlier, the South paid higher interest rates and this provided financial discipline. Now the question is, who pays for the last decade and who pays going forward? The rest of the world doesn't really care about the Euro zone.[?] Canada has a unified mechanism of collecting and redistributing tax revenues. [Europe does not want such a redistribution mechanism.]

Merz - The EU already has two speeds of integration, with some EU members not in the Euro zone. Europeans should not give up the idea of an integrated Europe. We cannot go back to the 19th Century. The Germans are tired of this process because they pay and pay. But Germany does get benefits, which are being forgotten.

Most southern banks would not get funds but for the ECB because private banks know the loans will not be repaid. This makes the debts a taxpayer burden. Could the ECB default? Is that conceivable? These adjustments in competitiveness will take decades to work out. The problem took 30 years to develop.

TOPIC 2 - INFORMATION TECHNOLOGY

MARIE-THERESE HUPPERTZ, VP Government Relations, SAP AG

Partnerships in IT are essential. SAP is not vertically integrated. It needs other companies. IT is the basis of the new, knowledge-based economy. It's the 3rd industrial revolution. These devices have changed the nature of work and human relations. Software pushes competition. For example, 80% of innovation in cars is software-based.

SAP invests 14% of its revenue into research. Other companies have not met the government-set goal of 3% .

SAP is looking for hundreds of new employees, mainly engineers. The educational system is not meeting these needs. SAP needs to have Germany become a place that can more easily attract the brightest from other countries. This includes greater cultural understanding.

WALTER KOEHLER, VP Global Services, OpenText Corporation [a conference sponsor]

Koehler's German company was purchased by OpenText (Canadian) 7 years ago. The cultures were quite different. Germans are thorough and slow.

For Germany, IT is a good industry because Germany has few natural resources.

Koehler sees his young daughter go to school carrying piles of outdated textbooks. This is a greenfield for software and IT.

The IT protection system is very inefficient and costly.

Many suitable candidates for IT jobs think of those jobs as day after day of programming in a cubicle.

Government purchase of IT is so inefficient and slow that the specifications are often irrelevant by the time the contract is put up for bids.

Cooperation between different IT companies is made more difficult by the question of who owns what if something is discovered.

Looking further at the government-IT interface, Germany is confronted by Stuttgart 21 and opposition to expansion of the Frankfurt airport. Germans are becoming more like the Arabs. [Not sure whether this means resistant to change or more willing to demonstrate and go to the street.] Some innovation is indeed not good. Take, for instance, the mortgage products which led to the housing bubble and financial crisis. Part of the innovation process is bankruptcy. This is an integral part of the high tech sector. But there are varying degrees of stigma which accompany such failures. Some failures are simply financial. Others, particularly in the pharmaceutical area, are more serious.

DR. GEORGE SCHUETTE, State Secretary, Federal Ministry of Education and Research

Foreign researchers can be divided into three groups: those who are top and sought out, those who HAVE to move from their home countries and the ones in the middle.

Germany's government-economic model succeeded in the 2008-9 crisis. Germany engaged in anti-cyclical spending. Germany continued to spend on R+D through this period. This investment in research has paid off. It also invested in universities and Fraunhofer research institutes. Siemens does not just make heavy equipment; it is a major software company.

Researchers need to reach a critical mass, for example through clusters and regional coordination. They can develop a common research agenda. Shortening time from development to realization is important.

Universities should bring industry on to campuses, as with CERN and the European Space Agency. Fraunhofer is present at the University of Western Ontario.

An example of innovation as a road block is the need for a common plug shape for electric autos.

Are Germans and Canadians competing with each other or cooperating to compete with rising China?

[Addressed: differing cultures, attitudes towards decision making and risk taking, consequences of failure, ownership issues. Not addressed: competition and cooperation between partners, compensation and ego management among team members.]

AXEL MEISEN, Chair of Foresight, Alberta Innovates - Technology Futures

The cooperation between academic institutions and industry is important but poorly developed. Few academics have industry experience. Universities need to give their professors opportunities to work in industry. This is also true regarding the arts and humanities.

German began its wind turbine industry in 1990. It has since then achieved a 365 fold increase in efficiency, largely through the size of the rotors. Canada is a huge source of wind electricity, with the US as its export market. Wind is the cheapest new source of power, with zero emissions.

General comments -

While visiting academics in industry is an interesting idea, lots of investment is involved and can be harmed by inexperienced visitors.

Risk assessment begins as children. Schools play a big role here. In Germany, each state controls its education system. East Germany faces its own, special problems as schools close due to declining population. The government should not change its demands of schools and pupils constantly. Mainly schools should teach curiosity. Parents also play an important role. They need to understand and support creativity.

A major issue in innovation in Germany is funding. There simply is not much risk capital in Germany.

3 - FOREIGN AND SECURITY POLICY

CEM OZDEMIR, Co-Chairman, Buendnis 90 / Die Gruenen

Speaking generally about his party, he said it is important that it not lose its "strangeness."

2011 has been one of the most challenging years. There are major problems in the US and EU and emerging powers are changing the dynamics. The G-7 and 8 have evolved into the G-20 but there is talk of a G-2. There are now 7 billion inhabitants and more coming. We produce more and more food, yet people continue to starve. Emissions are going up at a time when - due to the economic crisis - they would normally be going down. Add to this the Japanese tsunami and nuclear catastrophe. This led to an amazing decision regarding nuclear power in Germany. First the ruling coalition [CDU/CSU/FDP] added 12 years to the lives of Germany's nuclear power plants and then turned around and went BEYOND the

Green's expectations when they were in power. In addition, there has been the Arab Spring and a Green government in Baden-Wuerttemberg, a traditionally conservative part of Germany.

As to the Arab world, there is no one, unified Arab world. It is very diverse. The poor countries in the region had the hardest time taking refugees, yet they did it. Germany and the EU generally took very few. Then Denmark reinstated border controls. Immigration is still a fear in much of the EU. At the same time, aging of the current population should encourage immigration.

Turning to Turkey - The EU began negotiations with Turkey in 2004. They have dragged on to the point that Turkey is not so interested. The EU has lost influence there. It had hoped to anchor Turkey's foreign policy in Brussels. Now Turkey is trying out being a regional power.

The German abstention on the Libya vote was a major diplomatic mistake, not just by Guido Westerwelle but also Angela Merkel, if only to show solidarity with traditional allies. This mistake should not be underestimated.

The Euro is not just a financial crisis but also a political one. Greece has no real tax structure. The Spanish problem is not a state debt crisis, it is personal debt. Germany holds stereotypes of the South, not just in the yellow press.

Germany has greatly benefitted from the EU - in terms of peace, freedom, unification and economics. These benefits do not persuade most people in Germany. Political and economic leaders did not do their job; they did not educate the public. So many Germans are not persuaded that the EU has helped Germany. Greece has to have a European solution. The problem of interest on its debt has to be solved.

Yes, there should be a Euro bond, but the EU requires new treaties. These have to be discussed. To convince more Europeans, the process has to be transparent.

Furthermore, the European Council cannot just meet twice a year. The Council takes powers away from the nation states. To do that, the European Parliament must be stronger. Smaller states will object to one man - one vote. Perhaps the smaller states need more power in a second house. Germany itself faces its own constitutional hurdles in becoming more integrated in the EU. But the nation state is not the solution. The West has two significant events in common - the French and American revolutions.

DR. GEORG WITSCHHEL, German Ambassador to Canada

Canadians are not so convinced that revolutions are a good thing. Canada has one neighbor. Germany has 9 and over 60 years of peace. Direct neighbors are not a threat to Germany. But the problems Germany and Canada face require joint action.

Regarding climate change, Canada acknowledges the reality but nevertheless takes only modest steps. Regarding nuclear power, Canada has varying views at the federal and state levels.

Canada took a major role in Libya, flying the second greatest number of missions.

As to Resolution 1973 (Libya), where was the Chancellor in this decision? Angela Merkel said there was no difference between her position and Guido Westerwelle's. In her discussion with Barack Obama, Obama told Merkel that it "would not be honest" for Merkel to vote yes.

Regarding the Arab Spring, the EU has to open its markets to its Arab neighbors; this means agricultural and other products.

The Ambassador agrees with other speakers that the Euro is not just about money but also about peace and stability. It is hard for the current generations to understand what has been achieved since 1945.

The measure of investment in security is too narrow. Energy is also a security issue. Germany spends huge amounts on energy in these countries. Some of this money is converted into threats to stability. So investment in energy independence can be seen as an investment in security. Yes, we need fossil fuel. Gas is the most flexible of these fossil fuels. We need to diversify sources of gas.

JEFFREY SIMPSON, National Affairs Columnist, The Globe and Mail

The EU is important to Canadian security. Canada has a single currency and so needs a common fiscal policy and a mechanism for redistribution. How does the EU develop?

Witschel - Some kind of treaty amendment and stability pact will be required. The package of October 27th is a good one. Greece needs to head in that direction.

Comment from the floor, from a former ambassador - Germany took a pass on the Libya question. The Indian position on Libya was the worst and most transparently craven. Germany's recurring bid for a permanent seat on the UN Security Council cannot be taken seriously. The Council must be made up of countries willing to act.

Ozdemir - France and the UN "need to show they still count" at the UN. So they will not give up their Security Council seats. A possible goal might still be an EU seat. Yes, it comes along with responsibility.

Witschel - In defense of the German vote, no one knew when the vote was taken how the revolutionaries would behave. Some had been training Libyan security forces. Germany was not really neutral. It clearly wanted Gaddafi gone. Germany has a different tradition than other countries. It did not invite Gaddafi to set up his tent on government grounds. [A swipe at France, of course.]

Ozdemir - Many EU members do not want to become more integrated. The technical part scares people and there is no vision. Integration will not happen without a person who can describe the goal and a vision for Europe.

On the Greek question, the Euro zone members simply do not call each other on a lower, more informal level. There is no network. The relationships are still nation to nation.

Some Germans think Germany would do better without the Euro. The CDU/CSU is "back on board" supporting the Euro. Merkel has changed positions here dramatically since the beginning of the crisis. The FDP is campaigning in Berlin on an "anti-Europe" basis. Family companies are also skeptical. So the elites in Germany are not so uniform in being pro-European.

On the Brussels level, politicians do not want strong people there because they want to keep 27 foreign policies.

BRIGADIER-GENERAL CRAIG HILTON, Commandant, Canadian Forces College

Canada has always had a southern orientation. But it also looks at its perimeter. The US is "resetting" globally. Canada also looks at South America and its obligations in the Caribbean. So also Brazil, Columbia and Chile. Canada sees regional issues and economic interests. In particular transnational crime and unrest in Mexico.

Canada also has an East Asian market for its energy and commodities. So the Canadian focus is also shifting. Furthermore, the Arctic is opening. This creates multiple requirements. Canada and Germany share the same general security environment and issues of energy and climate security. Some forms of criminality can challenge the state itself. All these issues are transnational and expanded by information exchange. But the processes are best developed on a trans-Atlantic basis.

AMBASSADOR WOLFGANG ISCHINGER, Chairman, Munich Security Conference

We are in a watershed moment. A lot is changing. Germans love the status quo. We face three issues:

1 - The financial crisis and security. There is lots of pressure to reduce the defense budget. This has an effect on credibility and effectiveness. We need to create more bang for the buck. So we need to rethink and explore defense. In the EU each country indulges itself in its own military. This is not economically possible. We need to "go European." Each country can have its own specialty. The EU can save significant money through sharing and coordination. [Sounds easy. Is not.]

2 - "Out of area of out of business" - This was the comment about NATO after the reduction of the Soviet threat. The US and Canada cannot focus only on China. Hillary Clinton's recent major paper did not even mention Russia. This is a big problem for Germany. Obama's "reset" policy towards Russia may get lost or put at risk in the next election. [I am no longer sure what this means. I THINK Ischinger was pointing out a continuing threat from Russia.]

3 - Libya and Iran - Germany has serious disagreements on the use of force. When and in what way should force be used? Yes, Germany took a different stand on Libya. The key principle was to protect civilians. Force solves military problems, but not political. For political ones we need political concepts. These CAN include force.

PROFESSOR VOLKER PERTHES, Executive Chairman and Director, Stiftung Wissenschaft und Politik

There is no ONE German perspective. Germans forget that they have never been so secure. Germany can slash budgets for defense only because its people feel safe. There is no threat requiring a defensive role. Globalization and the absence of borders produce not just opportunities but also threats - disease and crime, for example. Piracy and terrorism and not new threats.

We face three clusters of challenges:

1 - Unresolved regional conflicts - often resulting from globalization.

2 - Governance failures, and not just failed states. Governments need to provide security and basic needs.

3 - Arab Spring - As a result of the Arab Spring there are 100+ million people who live more freely than a year ago.

These transformations need to be a success. Stability can mean stagnation. But many people do not like change.

Russia is not a rising power, although it is included in the BRICS. Broader participation in international organizations does not solve problems. Adding Brazil offends Argentina. So the broader the representation, the harder the solution.

The US will no longer be there to guaranty stability - such as in the Mediterranean Sea.

This new system is not run by one or two superpowers. Middle, regional powers play a bigger role.

Q+A - Who decided on what country plays what role militarily? How do we decide on a country's or region's "right to protect" the citizens of another country and create regime change. Who decides these things? What do we want? In Libya, there was a mandate, regional support and resources [I think resources refers to military and not oil.] As to Syria, a mandate does not exist. Sovereignty will be questioned. When the vote came on Libya, Russians knew regime change would happen. This is a problem for Russia and China.

Canada and the US do not focus on Europe because they think they do not need to. This should make Europe happy. It is easier to intervene with the tools we have. Drones are easier to employ and cheaper than the last generation of weapons.

When German military leaders discuss policy, they do it based on analyses they get from the US. Germany does not have its own sources of analysis. How can German military leaders have a credible voice?

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