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# THE EUROPEAN UNION POLITICAL CRISIS:

# WHAT CAN THE EU LEARN FROM THE U.S.?

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P R O C E E D I N G S

MS. HILL: Ladies and gentlemen, I'd like to welcome you on behalf of the Brookings Institution, the Center on the United States and Europe, to our event this morning. I'm Fiona Hill, the Director of the Center here. And we're really delighted today to have with us not only the Former Prime Minister and current head of the Alliance of Liberals and Democrats for the European Parliament, the Former Prime Minister of Belgium that is, not the Prime Minister of Europe. We haven't gotten there just yet, but that might be one of the things that we can talk about on the stage today; and also David Frum, one of the most prominent commentators here in Washington, D.C., from *Newsweek* and *The Daily Beast*.

We're going to have a discussion today about a whole range of issues related to Europe, hoping to move past the current political crisis and then to bigger discussions about EU-U.S. relations. We've obviously had former Senator and new Secretary of State Kerry's visit to Europe with a whole host of different issues on the table. Lots of exciting things going on from all kinds of questions about Italian elections to will the U.K. leave Europe? Will there be a new transatlantic free trade agreement?

We've got a lot of things on the agenda, but our colleagues are going to interview each other. We're going to start with a brief presentation and an opening statement by Guy Verhofstadt. And then David Frum is going to take it from there and do what he usually does, which is give us a great set of questions and insights and guide the discussion eventually into some participation from you, the audience.

Now, unfortunately, Guy Verhofstadt has another event at 12:30, so we'll have to wrap up on the dot on 12:15, so we'll have to keep our watches at the ready. And so I will turn over without any further ado -- but first I'd also like to thank a couple of our colleagues who are in the audience. This is part of a series of events on Europe that we're doing with our colleagues across the way at SAIS and the Center for Transatlantic Relations. We have Andras Simonyi and Daniel Hamilton with us and a whole host of other colleagues who are here. And we have been engaging with SAIS for some time. We're planning a bridge across the road, a little bit like one of those rather ornate, Italian-type bridges at some point when we raise the funding, of course, for that to cement our relationship.

We'd also like to thank the European Parliamentary Liaison Office here in Washington, D.C. A number of our colleagues are with us who have made it possible for Guy Verhofstadt to be here with us today.

So thank you very much to everyone. Prime Minister Verhofstadt and David Frum, over to you.

PRIME MINISTER VERHOFSTADT: Well, thank you very much. First of all, you said it shall be a short introduction, but with a politician you never know naturally how short the introduction can be, but I do my best. And first of all, ladies and gentlemen, it's not the first time that I'm coming to Washington to give an introduction about the EU crisis, the crisis of the European Union, and what can we learn from the United States.

I think it was six years ago, I was at that moment Prime Minister of Belgium. I made a speech in Washington about the same topic. It was not before such a prestigious institution as Brookings; it was CSIS. I hope that there are no people of CSIS in the room. So today I'm back in a quite different context, I should say, because compared to six years ago, yes, the European Union is in the midst of a serious crisis. And I shall not give you a whole overview of everything that happened the last years in Europe. But you have certainly followed to the Greek crisis that started in December 2009; the Portuguese financial crisis in 2010; the Irish debt crisis also in that same year;

then problems in Madrid, in Spain; problems in Italy. So we have to recognize that since the outbreak of the financial crisis in 2008, we are in the midst of a number of serious problems.

And the question that I want to raise with you this morning is what went wrong in the European Union? What is the reason that there is a crisis in the European Union because you're doing find in other parts of the world. You can say that there is no growth worldwide if you look to a number of figures of a number of regions. What is happening exactly in the union? What is going wrong? And I put this question as a convinced European, somebody who believes in a more integrated -- I shall use the word -- a federal Europe because as many of you well know, we also have many people in Europe that believe that it is the existence of the union itself that is the problem and certainly not the solution to our crisis. They would rather retreat behind their national borders, as was the case in the 19th century in a world of old-style powers, old-style nation states. And, in fact, many of these people don't understand that this world definitely no longer exists, that the 19th and 20th centuries are clearly behind us.

I'm always saying when your President Barack Obama cannot deal himself with climate change, cannot settle himself trade agreements with, for example, China, what chances are there for any single European country to achieve this on its own? And, moreover, I'm always giving the example of what shall be the G-8 in 30 years from now in 2040, something like that? The G-8 shall be the U.S., Japan, China, India, Brazil, Russia -- I think I've given six names now -- and the last two shall be Indonesia and Mexico and one single European country.

Nevertheless, I think that the challenges are huge. It is our societies that are at stake, our principles, our way of life that counts in this world of tomorrow. And I think it's certainly necessary that the two big continental blocks, Europe and the U.S., are working together, one-seventh of the world population, still 50 percent of the world's GDP, also two continents that share the same freedoms.

But let me return to my initial question. What went really wrong in the European Union? Well, I think that mainly when we talk about our problems, we have to talk about the Eurozone where we made by establishing this Eurozone a number of fundamental mistakes. We created, as you know, a monetary union, but we did not install at that moment an economic union, a fiscal union, a banking union. And today we all know that it is impossible that a single currency with 17 different governments, 17 different bond markets, 17 different economic strategies that it simply cannot work. I'm always saying maybe a state can exist without a currency. There are a number of examples of that, but there was never a currency and there is no currency in the actual world without a state, a state authority that can guarantee the economic, financial, and political conditions to sustain the currency.

Nevertheless, the European decision makers 13 years ago thought exactly the opposite, exactly the opposite. They thought that it was possible to introduce the euro without the necessary means and tools, and that all of these necessary means and tools should become spontaneously a reality. In a nutshell, they thought that it was possible to have a single currency, the euro, based on two specific rules, two basic rules. The first -- and you know them -- no public debt higher than 60 percent, and secondly no fiscal deficits higher than 3 percent. And do not get me wrong, these rules are sound. I do not criticize them. But the Founding Fathers of the Eurozone made the mistake not to foresee, in my opinion, a public authority at the Eurozone level to impose them; a public authority strong enough to prevent member states from breaching them; a public authority with the necessary means and tools to sanction them and to penalize the sinners. They thought that the sinners should penalize themselves. Well, this in my opinion is certainly in politics a very naïve opinion.

So that was not the only mistake naturally we made. Every time the stock markets are going up and the so-called spreads down, many in the European Union believe that the crisis is over. And I think it's sufficient to see the effect of the elections in Italy to realize that this is completely wrong. It's enough that a single election goes badly for the markets to react immediately with a number of devastating consequences across the union, and you have followed that. In 24 hours the spreads for Italy went up 100 basis points -- that's 1 percent more than just before the election and with contagion to other markets to Portugal, to Spain, and so on.

So the crisis around the euro, the euro crisis, is not over. And this crisis, in my opinion, and that's my message of today, this crisis needs a structural solution, an in-depth solution and reform, because despite endless meetings since the outbreak of the crisis in December 2009, the European heads of state and government have, in fact, in my opinion, not been able to agree to such a structural solution. And moreover, in my opinion, that is because they are, in fact, unable to do so, not made to do so.

The European Council that is in the middle now of the decision making inside the European Union is, in fact, in my opinion, not made to govern Europe or to manage the euro area. And, moreover, I think that the European Council does not even represent the interests, the general interests, of the European Union. It represents mainly the amalgamated interests of individual member states. This little bit -- if I can make this comparison -- as if the United States was to be run by the 50 state governors.

So you imagine that? No Obama and no American administration, not at all. Even Capitol Hill can disappear, not completely, but at least partially. And you have then the 50 governors alone coming together five or six times a year that have to provide the policies for the United States. Do we enter Iraq, yes or no? You have 50 state governors around the table. What do we do to make the dollar more sustainable and all this by unanimity. And you know better than I do, I think, that unanimity is certainly not the best way to govern a country and even less a continent. And that was already a lesson understood by your Founding Fathers over 200 years ago. Unanimity kills any, in my opinion, real capacity to make real change.

And besides this ineffective way of governance and the lack of real sanctions to ensure fiscal discipline, we have also made -- if I can give the complete analysis -- a third fundamental mistake when we launched the euro. I call it the other side of the coin. If fiscal discipline is one side of the coin, you need another side and it's then solidarity. Without solidarity, a monetary union can simply not exist. It's, in fact, the essence of a monetary community. And it's clear that such a form of solidarity can take different forms. It can be a monetary fund. It can be by the way of a partial mutualization of debts or by common issuance of sovereign bonds, you know, the way Hamilton did it more than 200 years ago. Or finally it can also be done by a serious federal budget, a budget that can finance common policies and can be the basis for debt currency.

Well, the main problem in Europe is that none of all this exists in Europe. Besides two limited rescue funds -- you know them, the European Financial Stability Facility that is a temporary rescue fund that has been created in 2010, and besides the more permanent European Stability Mechanism, the ESM, what is the follow-up of the EFSF. Besides that there is, in fact, nothing at all. The only thing that we have is a budget of 1 percent. And let's be honest, a European budget of 1 percent -- I compare it with the 24 percent of the U.S., nevertheless not always easy to agree on the 24 percent apparently, but it's not this 1 percent that can make any difference.

And, moreover, the lack of real independent revenue inside the union makes the union a hostage from the member states. And we all know if we want to tackle the problems in the European Union, we need a bigger budget with a direct income for the union so that the union itself decides on what needs to be funded. And so that you can also establish what is normal, what is the evidence, in a true democracy, a direct link between the citizens and your public authority in your country so that it can see what it pays for. That can be a federal VAT, a value added tax, as exists here in the U.S. It can be a carbon tax or a financial transaction tax. Ladies and gentlemen, in any way, you need some real direct funding of your federal authority to be credible and to be effective.

So a union that does not work well because of ineffective governance is not only an institutional issue, not only an institutional problem, it is, in fact, people and economies that suffer most from it. And let me give you one example. I'm very convinced about it. Had the European leaders, for example, decided in December 2009 to help Greece immediately and then they should have established, for example, at that moment in December 2009 a new surveillance mechanism of that budget in exchange for greater financial support, I think we would not be in the crisis we are today in Europe. And also I think that many millions of people would not have suffered. But because we have given the impression that we could kick out one of the members, then a monetary union no longer really exists.

And so the price of inaction and the cost of ineffective institutions in the European Union is for the moment very high. Too high, in my opinion, and see what it does, for example, for the moment in Italy with half of the population voting for two populist parties and what happened? One party, the party of Berlusconi that created the mess, I should say, and the other populist party, the party of Beppe Grillo, that is simply opposed to politics, opposed to the system. Or look if you want to at another example, to Greece, where extreme populists, even outright fascist parties, emerge for the moment.

So my clear message of today is that we must change drastically the way we govern Europe. We must, in my opinion, as fast as possible, introduce what I call the federal way because federalism guarantees not only the respect of differences, it provides also mechanisms for taking decisions by majority, ensuring democracy, ensuring effectiveness and transparency.

And then the question is what does it mean for the European Union, such a change in a federal system? In my opinion four building blocks: First of all the establishment of a true European government that doesn't exist at the moment that should be, in fact, a drastically reformed European Commission. Secondly what you need is a true European Treasury with a Treasury Minister at its head. It should be, third, a federal democratic control with a European Senate, a second chamber representing the states to work naturally together with the European Parliament representing the European citizens. And fourth, a common European bond market, and we could start with what we call a European Collective Redemption Fund that is the idea to mutualize debts above the 60 percent mark, to create a liquid market of 3 trillion euros and that would be a real game changer that should convince the markets.

In short, I give you these four building blocks and you're American, you say yeah, that's exactly what we did in the 18th century more or less. And you started in 1776 with the Declaration of Independence; in 1781 with the Articles of the Confederation still based on unanimity; and then in 1787 the big change, the Convention of Philadelphia, in which the Articles of the Confederation were fundamentally changed in a real Federation with Article VII stipulating that an approval by nine of the 13 states was sufficient to approve the Constitution and bring it into force; and then 1790 with the Hamilton moment. We are still waiting on our Hamilton moment in the European Union. The first head of the Treasury will introduce Treasury certificates after a huge battle with

Thomas Jefferson, but also fruitful Thomas Jefferson because Washington has been created in that deal at that moment. And then it's only later, in 1792, with the Coinage Act that the single currency was established and only in 1913 that the Federal Reserve System emerged.

So the historic development in the U.S. is quite clear. We are more intelligent in Europe. We do exactly the opposite. We start with a single currency and then we say oh, shit, we have a problem. We don't have an economic union, a fiscal union. The banking union is not there. We have no sanctions. There is the difference with what's happened here.

So, ladies and gentlemen, I think that we need as fast as possible to make this new federal system in Europe and also for our American counterpart because only a unified Europe based on the example of our American counterpart can be a long-term and reliable partner for the U.S. It's, in fact, the choice, the choice between the disjointed efforts of 27 small states or a single, solid partner. And I think that in the globalized world of tomorrow, the interests of the United States is to work with a single, solid partner at the other side of the Atlantic Ocean and not 27 different member states. And I think also that this cooperation can ensure that our values and principles become the benchmark across the world.

And that's the reason why I'm -- and that's my conclusion -- I very strongly support a free trade agreement between the U.S. and the EU. It's clearly, I think, in the interests of both. It would lead to an increase of 100 billion euros in the GDP of the European Union to approximately the same figure, 90 billion, in the U.S. It should lead also to an increase of exports of both country lands. The forecasts are 6 and 8 percent of increase for both. So I think -- and that's my end -- I think we have all interests first of all for a debt reform of the European Union and as fast as possible this trade agreement and cooperation between the two blocks.

And to end, ladies and gentlemen, I want to end with a quote of George Washington because he was not only your first president, but he was also a European visionary. He wrote in a letter 200 years ago in a letter to his European friend, the Marquis of Lafayette, the following sentence. It's interesting to repeat it for you: "I am a citizen -- I'm quoting him. "I am a citizen of the greatest republic of mankind. I see the human race united like a huge family by brotherly ties. We have made a sowing of liberty, which will little by little spring up across the whole world. And one day, one day, on the model of the United States of America, a United States of Europe will come into being. The United States of Europe will legislate for all its nationalities."

Well, you can say that he was well ahead of his time, George Washington, even by today's standards; certainly when I'm comparing him with the actual Prime Minister of Britain, Mr. Cameron, he's really well ahead. But George Washington was convinced that no matter what, the Europeans will come together, will form this United States of Europe. Let's be honest. This was thinking outside the box. You can say that certainly in the 18th century, and few would have thought that there is a chance for that to happen.

But there are also people, people like Jean Monnet, Robert Shuman, who, in fact, view the United States as the source of inspiration. In all difficult moments, the United States of America has opted for more cooperation, more federalism. And having done so not only it survived, but it flourished as never before. Well, let's take a lesson from them. The same is necessary for Europe, certainly in the globalized world of tomorrow.

Thank you for your attention.

MR. FRUM: Prime Minister, thank you for your very lucid and candid remarks. And on behalf of the inhabitants of Washington, D.C., thank you, too, for your compliment of suggesting there are any lessons for Europe to learn from American governance. We think we are setting world records in dysfunctionality here. It's impressive to hear that anyone thinks that we have anything positive to offer.

You stated very emphatically and very clearly the requirements for a successful monetary union: A common government, a common treasury, fiscal policy, banking policy. None of those were in place, as you say, when the euro was launched. In that case, was it not reckless and irresponsible to launch the euro? This is like -- is it not -- is this not like saying I want to go to sea and I know I'm going to need water, food, fuel, and maps. I have no water, food, fuel, or maps, and I'm going to sea anyway.

PRIME MINISTER VERHOFSTADT: I agree with you, but you have to understand why it has been established, this euro. This euro was not an economic project, was not a financial project. It was a political project, a pure political project. After the fall of the Soviet Union, a deal was made between France and Germany, between Francois Mitterrand and Helmut Kohl. And Francois Mitterrand said okay because you remember that prior to even all the Western leaders, Western European leaders, ideas to create two democratic Germanys at that moment. I think that even Mitterrand played a long time with that idea. I think a stupid idea, but at that time that was in the air. And finally, Mitterrand understood that it was impossible to go against this trend of unification of Germany. And he asked for a price, and the price was okay, I shall ask for a common currency and then to establish really Germany in the middle of that monetary union so that never again, never again, Germany can break away of the system.

That's the reason why we created it, why we introduced the euro. It has been prepared in an appropriate way, no problem with that. The launch was, in fact, a success in most of the countries, but the problems emerged immediately in the sense that if you don't have an economic fiscal union and only a number of rules, it is not sufficient. It's maybe sufficient in a time of economic growth. In the beginning of 2000, 2007, there was five, six, seven years of no problems, low interest rates in the European Union. Everybody benefited from that, and then comes the financial crisis in the union, a financial crisis that emerged and that created not only another problem, but another debt problem in a number of countries. And because it is the main reason of this increasing debt since 2007 in the European Union, like it was also the case in a certain way in the U.S.

And so at that moment, what you see is that you don't have your economic union. You don't have your fiscal union. The only thing that you have is a number of rules, rules that have not been applied by the EU, by the two big countries in 2003 and 2004. The first two members of the Eurozone that don't apply the fiscal deficit rule of 3 percent are France and Germany. And they are saying yeah, but we are under exceptional circumstances, and in monetary issues there are always exceptional circumstances and so we cannot apply them. And that created, in fact, the sentiment not only inside, but also to the markets that this was not really built on sound policies, a sound economic and fiscal union.

And then you have naturally in December of 2009 what happened really is very simple to explain because the public finances from Greece were already very bad, I should say, years and years. But what happened was that the rating agencies downgraded Greek bonds to Triple A plus. That should be very good today, but at that moment Triple A plus was a real problem. And at the same time the European Central Bank announced an exit strategy that meant that she should no longer accept Triple A plus as collateral for liquidity for the banks. So everybody had in their portfolio a number of bonds that no longer could be used as collateral so that the crisis, in fact, was born.

MR. FRUM: The euro may not have been an economic project at the inception, but it had economic consequences from the inception. And those consequences have been catastrophic -- the worst economic disaster to strike the European continent since the Great Depression, millions of people out of work, millions of people losing assets. And those consequences showed up immediately. As you say, those low interest rates created a tremendous incentive for people in the southern part of the continent to borrow and import, and it created an incentive for people in northern Europe to export. From the beginning France saw its share of world trade collapse. From the beginning Germany saw its share of world trade rise mostly at the expense of France.

Now we see a continent with unemployment rates of Great Depression level across the bottom half. It's a calamity. It's a catastrophe. People are turning on their political leaders, and those political leaders are saying, what did we do? Why are you blaming us? Is there not -- should we not begin with kind of a moment of accountability and responsibility that said the euro was a terrible mistake and at this point we have only bad options, and the people who created this mistake need to be held to account?

PRIME MINISTER VERHOFSTADT: Well, first of all, our people thinking like that about the euro, every poll on the euro whether it's in Greece or in Spain or in Italy or in Portugal has a convincing 70 to 75 percent faith in failure for the euro. Greek citizens say Spanish citizens are not stupid or Italians certainly not. They're saying, if I lose tomorrow the euro, we go back to the old policies of our political predecessors. You know what it was. It was every two years a devaluation of the local currency, of the lira, of the drachma, to regain competitiveness because of a lack of free form in the country. Any who is paying the bill in the devaluation? The normal citizen who is, in fact, losing purchasing power and that was happening every two years. And that is the reason because it is a contradiction even that all of the difficulties with what is Europe asking. And at the same time if in a poll you ask what do you want? Do you want to continue with the euro, the single currency? They say yes, I want to continue with the single currency.

So the problem is not the euro itself, the problem is lack of reform in a number of countries in mainly the south, but not only in the south, take France, for example, of the European Union. And what is helping now is that the euro can create the pressure to all these countries to reform and to do what is necessary. And not to do what they did in the past because that's no longer possible. They have no longer their local currency to devaluate and to regain competitiveness in that way.

Was the euro a good initiative? First of all it was politically, certainly, a wise decision. It was not well prepared that we discussed already, but a number of countries have an enormous advantage of it. Countries like Belgium, my country, or The Netherlands, certainly Germany, but also a number of other countries all monetary bonus were abolished. I can give you a figure for a country. It's not my country, but The Netherlands. The Netherlands, guess why? Because there was an election. You have followed that maybe, six or seven months ago, in which a political party, an extreme right wing of Mr. Roga, said we want to get rid of this euro. We want to get out of the Eurozone. That was his bid to the election, and he lost one-third of the electorate in the election. Why? Because the Dutch are not stupid. They know something about figures and so on, some people said even too much. And there were analyses showing that, from all financial institutions, showing that if the Dutch should go outside the euro system, there should be an economic downturn three times bigger as the call-up of Lehman have had on the fact of the Dutch economy. Why? Because it's an export-oriented country.

MR. FRUM: So you've created -- to us it sometimes seems that what Europe has built is something like the doomsday machine from *Dr. Strangelove*, a giant explosive mass under the continent that will kill you all if you get rid of it quickly, but is killing you all slowly. I mean it's true. It used to be in Italy people would lose 2 or 3 or 5 or 6 percent of their purchasing power every year. Now the unemployed lose 100 percent of their purchasing power all at once and not just for one year, but for year after year and year. And in the case, it's now -- we're now closing on half a decade of mass unemployment -- 50 percent for young people in Spain and Greece. People in Spain we are seeing the beginnings of immigration. It's true. The Dutch and the Belgians and the Germans have profited hugely, and their suggestion for the way to solve the problems is that all the people who are suffering must change and all the people who have benefitted get to stay the way they are.

PRIME MINISTER VERHOFSTADT: That I agree with you. It's what I said, that there's the other side of the coin I was talking about. There is that micro decision to actual policies in the European Union is that they only tackle the question of fiscal discipline. That's absolutely necessary. I'm a former Minister of Budget. That was when I was young. I started as Minister of Budget with a fiscal deficit of 16 percent of the general government in Belgium and with 137 percent of debt to GDP. So we know what we are talking about, how to manage it. Fiscal discipline is absolutely necessary for growth in the long term, but if you do it for the moment and that is what is happening, you do only fiscal discipline and you don't organize. Also solidarity, growth, investment in a certain way on the European level, you have the mess we have today and the problems we have today with massive unemployment in Portugal, in Spain, as you indicated.

And that's the problem for the moment. There is debt. The European leaders see the fiscal discipline as one huge principle to have a sustainable union. They don't for the moment enough recognize the other side of the coin, and this is solidarity. And that means, in my opinion, a bigger budget or a European bond market or a mutualization of debt partially of globally and why? Because then you can create markets. You can attract savings. You can launch investment in Europe, what we desperately need.

Let me give you an example to show you what the problem is, an example of a small country. So I'm not talking about Spain, not about Italy. So I'll talk about the country that is nearly fully compliant with the stability pact, Slovenia -- a small country, 2 million people, less than 60 percent debt, so compliant with the stability pact. They have a fiscal deficit between 3 and 4 percent, so it's not the best pupil of the cause, but there are much more problems in other countries. You know what they are paying as interest rates? 5.66 percent was their last financing cost for the government. And they put it in dollars in the market, not even in euros; otherwise they would have paid more than 5.66 percent.

So a country fully compliant, but fully nearly compliant with the stability pact, why? Small market. Whose interests are the people here in Slovenia? I don't think so because it is a small market with no liquidity. There is a basic principle that all these leaders in Europe have forgotten. In bump markets, it's liquidity what counts -- the higher the liquidity, the lower the rates. Even before the financial crisis, the interest rate in the U.S. was lower than the interest rate in Germany, before the financial crisis. I'm not talking about the actual situation. Nevertheless, the public finances of Germany are far better than those of the U.S. Why? Because of liquidity. The bond market in Germany is thousands, 1 trillion. The bond market in the U.S. is 10 trillion. That's the difference in size, and that's also a difference in interest rate.

And the second point is you don't have a credible authority behind it.

The problem is a structural problem. It's not only a question of this structural problem. You have no real common strategy that can oblige member states to do the reforms that are necessary and that creates also this increase in interest rates. I'm always comparing with Japan, 26 percent of the lowest interest rates with what?

MR. FRUM: But isn't one of the reasons that the United States and Japan, despite their fiscal problems, have such low interest rates is that no investor doubts --

PRIME MINISTER VERHOFSTADT: Exactly, confidence.

MR. FRUM: No investor doubts that if worse comes to worst, the Japanese government can make yen and the United States government can make dollars. But the Slovenian government can't make euros, and that is what they are being punished for. I mean you have this -- the vision you present is one in which you say people will be punished until they reform. Do you worry about what that means for the stability of European democracies? We are seeing -- you mention Greece. We are seeing -- on the fringes of Europe, we are seeing some countries backsliding away from democracy. The patience of the Spanish people is almost superhuman, but there are limits to everything. Italy has had a protest. It seems so far to be not a protest with a lot of content, but it is an expression of repudiation of political leaders. And who can blame them?

PRIME MINISTER VERHOFSTADT: No, I think it is already not only a euro crisis, but a crisis of the union as such, and political and not only financial or economic. You have to make the good analysis or the good conclusion. What is the good conclusion from that? To go back to nation states? To go back to 17 different markets? To 17 nations with their own currency, with their own -- I don't think so. In the globalized world of tomorrow, it seems not to be a good choice to make, to go back to nation states. No, you have to go do your work and go further in your integration and to do everything that is necessary. For example, that means that you have to oblige, for example, countries like Italy to change their labor market because if they don't change their labor market, there is an increase in their rates that puts the pressure on the euro and that puts a political problem in the union. The fact that there is an obligation to do reforms in all these countries and why? Because you have a common currency, a common destiny, and a common economy. So the question is, what is -- we know what the problems are. The question is what way we go? We go back to a new confederation of 27? I don't buy it. I think that's the wrong choice to make in the globalized world of tomorrow. Or you go further in what is a normal way of thinking because the difference in the U.S. there are also, but with not the same consequences. If, for example, California goes bankrupt, it's not that the whole American system is collapsing and the dollar is disappearing. If a small economy like Greece, only representing 2 percent of the European GDP, has a problem, the whole system is in shock because of the lack of a real federal system.

MR. FRUM: But when you talk about going forward, what that would mean if you were really to do it, if you're to follow the American example, the Hamiltonian Project and all that's come after, that would mean that taxpayers in Belgium, in The Netherlands, in Germany would say we accept to be fully responsible if need be for the pensions and health care of people in Portugal, Greece, Slovenia, Poland when they join. We will pay if need be the way people in Connecticut today are responsible for all of the obligations -- and I'm not talking about government debt, I'm talking about the social welfare system of Kentucky and Texas. Is there any sign that your taxpayers in Belgium would say yes, we agree to pay the pensions of people in Greece. We agree to pay the health care of people in Greece. And if they won't do that, then your fiscal system won't exist and, therefore, by your own description, your money system must be a failure.

PRIME MINISTER VERHOFSTADT: Well, in fact, they are paying now for it. That is what happened.

MR. FRUM: Yes, but for how -- your fiscal transfers are what, 2 percent of European GDP? I mean ours are -- our federal government moves -- an insurance company with an army. Our federal government moves around somewhere -- right now it's more, but historically about 20 percent. It's vast. Kentucky would not have Social Security, Medicare, and Medicaid on its own. It couldn't possibly afford them. It's paid for by the people of Connecticut and California and other states.

PRIME MINISTER VERHOFSTADT: Well, it is -- if I can come back a little bit to the pure financial problems because there we are paying. So the taxpayers of the north, taxpayers in Belgium, in The Netherlands, in Germany are paying for the moment to these rescue funds. And because of the rescue funds, we can give sustainable lower interest rates to these countries to finance their public debts. That's happening now.

What I'm saying is there are maybe more intelligent ways to do it; that is by mutualization of debt under strict conditions; then you pay less interest rates to the bond holders. Now what we are doing is that we are asking for money from the taxpayers. We give it to Italy, Spain, Portugal, and they pay this high interest rate to bond holders mainly outside the European Union.

Now I think that there is a more logical way to solve the problem, the Hamilton way. That is debt you mutualize partially and that you pay less interest rates on Italian bonds, Spanish bonds, because they are mutualized in the European framework so these bond holders receive less interest rate. That costs less taxpayers money.

That said, yes, if you develop a federal budget of a certain size, you have automatic transfers inside. Are people against it? In any way, not the Dutch rules I'm talking about. They knew very well. The question was very simple. Do you agree, yes or no, to help more of the Greeks? And I can tell you in a climate and an environment that was very bad because everybody said no, no, the Greeks, they don't work. There's always sun there. They have a good pension. They have never paid for that -- all stories that most of them are not true or not completely true, but that was the image of that. Well, they said no, no, we'll go for it. We don't want to lose the euro. If we have to be in a certain part more solid with them, we shall do it because we gain or so from all this.

So you can explain it to people. You can explain that it's not in their interest that the euro disappears and that there is a massive assault of euro because it's their markets. The logistic firms of the Dutch are exporting to what? To Greece, to Italy, to Spain. You have to see the figures of Germany, for example, you have raised yourself when you were talking about an enormous gain of euro for Germany. Well, it's true. Germany had to balance trade balance with Greece before the introduction of the euro. Now we have an enormous, excellent, surplus in debt trade balance with Greece. So they knew it. They are not stupid. They are saying if we destroy that system, we destroy also the engine of our wealth.

So there is nothing free in the world. So if you want to gain on your export markets, you have to be a little bit more solid on your transfers.

MR. FRUM: I will now turn to the audience for questions. I will reserve the right to ask the last one, but we have 25 minutes before the Prime Minister must go to his next appointment. Sir, in the orange vest.

MR. KANE: Hi. My name's Oliver Kane. I'm a U.S. correspondent for an Austrian newspaper here in D.C. I was in Brussels before for four years. Don't we, in fact, already have that source of treasury in Europe? You've got the ESM and you've got an ECP president who says it will do whatever it takes to keep things going. So why don't we simply double the ESM? At some point after the German elections we might get Ms. Merkel and her coalition partners to agree. And then we could even face an Italian problematic situation where the ESM would step in because currently the ESM, of course, would be too small. I mean it's kind of an improvised solution, but I don't really see where your big quantum leap should come from with that set of politicians we have. Thanks.

PRIME MINISTER VERHOFSTADT: Well, let me first of all say that Italian debt is 2 trillion, so even when you double the ESM you have not enough for that. Secondly, ESM is a typical system of what I said and what I have criticized, a rescue fund where you take taxpayers' money and you give it to a country to pay a high interest rate mainly paid outside the union. So you pay an interest rate of 5 percent or 6 percent or 7 percent because of the crisis. In the mutualization system -- that's not the ESM, that's a collective redemption fund or a euro bond or a system of euro bills, of treasury certificates and the Hamilton way -- you don't pay 5, 6, or 7 percent. You shall pay 2.5, 3 percent. It shall be a little bit more than what you pay on the German bonds, but not what we have today.

So it's a far more, I should say, cost effective system to deal with your problems. It's huge also, right? It's 3 trillion in a collective redemption fund when we talk about all the debts above 60 percent. So that's the reason why I think that's a far better system than simply a rescue fund. And a rescue fund is intergovernmental and we shall see how it works because every time when there is a country that is supposed to do something, they come back at ESM. It's intergovernmental so you need unanimity.

Secondly, it also can no longer continue with the OMT. The OMT was absolutely necessary, the outright measures that have been proposed and launched on the 6th of September by Dragi. But my fear is that it has not only taken pressure away from the market, it has also taken pressure away from the politicians to do what is necessary. Because it's our hope Mr. Dragi, if there is a problem, he shall buy bonds in whatever quantity of a country in difficulty. And this is what the OMT mainly is doing. Also that is if it is used, a very cost ineffective system, and that is not sustainable on the long term. The only sustainable system on the long term is a mutualization, a common bond market that can lower the interest rates.

MR. FRUM: I'm going to take questions in bulk if it's all right. I'm going to take two from this side of the room and two from that side of the room. So there's one in the back corner, sir, in the back there, and then Ambassador Simonyi. And then I'll take two over here that I'll take after that.

SPEAKER: Jeffrey Stacey from CTR SAIS. Two questions, Mr. Verhofstadt, one economic and one more foreign policy related, if I may. Would you agree that American observers who sort of would now like to say I told you so and have all sorts of schadenfreude to say to their European counterparts these days, would you agree that they could be usefully reminded by you of the decades of benefits of first the customs union in the free trade area, then the single market, then the single currency, and single monetary policy, that they were broad and wide benefits for Europeans for years and years for these things.

But then I'd like to ask you another question. Lately you're seeing European countries, including your own, and in particular Britain and France act in a military fashion outside of the European framework somewhat successfully or even very successfully to observers here. Certainly my former colleagues at the State Department are now pleased with these things and after the Libya operation view these options as being positive, new options on the table in an era of austerity. Presumably you're in favor of combining European armed forces. Could you say something about that for us?

MR. FRUM: And Ambassador Simonyi.

SPEAKER: Thank you. I'm so honored to be representing one of the cohosts. But I'd like to come back to a question that David raised, and this is related to the backsliding of democracy. I mean while we have a huge crisis in Europe, it seems to me that there are strange ideas, strange economic ideas, but also the unraveling of the checks and balances in some countries. And I just want you to address this. I mean how is Europe going to deal with this? I don't think you can deal with the economic crisis first and then move on and we'll deal with the deficit and democracy second because we might really have a major, major issue. It's no secret. My own country, Hungary, is backsliding with the checks and balances. And some politicians even look to Vladimir Putin as their role model and being excited about the alternative. That's a pretty scary thing, but I want you to answer that.

PRIME MINISTER VERHOFSTADT: Maybe on the first question I'm very much in favor, indeed, of a more integrated Europe, not only on monetary issues, economic issues, tax issues, but also on foreign policy and defense. And I hosted as Prime Minister what has been called afterwards, a little bit cynical, the Chocolate Summit. It was in Brussels so that's the reason why they call it the Chocolate Summit, and that was in 2003 where we launched a number of common policies on defense, a common European headquarters, for example, to launch our operations when we have military operations outside the European Union. And it's, in my opinion, one of the priorities to do in the coming years.

Also for reasons of public finance, I should say, because what Europeans, what is Europe military, what Europe are 27 states who are spending between 40 and 45 percent of the American military expenditures, so that's a lot of money. You can say oh, it's not so much. It's only 40 to 45 percent of the American expenditures, but that's a lot of money and only we can do 10 percent of the operations of the American Army. So if I do my mathematics good, that means that we are four to five times less effective than the American Army. That's normal because you do 27 times the same thing and you are not integrated in neither the navy, neither a strategic transport, neither intelligence. You name it; it's 27 times the same. There are a number of small cooperations, but they are really not counting at all.

So defense is certainly the key, and it can help to reduce deficit and at the same time you create your community. I'm always saying how to have a common foreign policy? Well, for a common foreign policy, you need the diplomacy that is common and you need the commonality. Then you're obliged to have a common foreign policy. I was not the president, but I was a member of the European Council, when in 2003 I raised the question and it was in Spain -- it was a villa in Barcelona -- and I asked the colleagues should we not discuss a possible invasion of the U.S. in Iraq and what our position is? That was the question. And Chirac took the floor and he said I don't think that it's interesting because we don't agree. Is it not, Tony? Yes, Jacques. We don't agree so it's not necessary. So one minute, that was the discussion on Iraq in the European Council. That is the foreign policy of the union on a huge issue I think, still a huge issue of the invasion of Iraq.

So if you want to change that, you need first of all the instruments because if you have the common instruments, then you are obliged to do so. But I'm very much in favor to go in that direction. Maybe you can already show that in Syria where we do nothing at all what is shameful for the moment that we are not capable to develop whatsoever policy.

And then on deficit and democracy, it's true. We have a whole system of values, infinite procedures, how we have to tackle problems with a lack of democracy inside the union, that's inside the Lisbon Treaty. They are, in my opinion, far too complicated with too high thresholds before the union, in fact, can act. A four-fifths majority before you can denounce a number of things on that issue. So I believe that we have to develop that as fast as possible and that we need to have the courage to tackle them because that's a problem. We have an intergovernmental system. And you know how it's working in an intergovernmental system. I explained it a little bit, making a completely idiotic comparison with the 50 state governors coming together. But if you have these 27 coming together, you know how it's working. They are never pointing the finger to another. Maybe they need the other tomorrow to make a deal, a deal on the budget, for example, because also the budget is made by these 27 heads of state and government, and that is the main problem.

You need a system based on a government an elected parliament, a senate representing the states, and they have to have the full power to not only govern Europe, but also to sanction those countries who are not fulfilling their obligations under the treaty and not to give this to heads of state and government.

MR. FRUM: I'll take another question, here in the second row, these two gentlemen here.

MR. ASLUND: Thank you very much. My name is Anders Aslund. I'm at the Petersen Institute for International Economics. I very much welcome your strong advocacy for a federal euro. And my question to you is how would you concretely try today to convene a relevant group of people who would push forward this, what way forward do you see? Thank you.

MR. FRUM: And the gentlemen immediately to your left.

MR. MATI: Thank you very much. Matias Mati. I'm a professor of political economy at SAIS across the street and also from Ghent, the Prime Minister's native city in Belgium. It's a pleasure to see you here with the same energy as when you turned Prime Minister in '99 when I was a college student, and it's great to have you in Washington.

I want to follow up on Ambassador Simonyi's question on legitimacy. If you look at the U.K. now, they're doing austerity, but it's their choice. They chose this policy. They continue it. They might not like it, but it seems to me who is Olli Rehn, one of your Belgium natives and a former minister of the federal government who asked. And now again, Olli Rehn says well, no matter what the Italians do in the elections, they will have to continue with the reforms Europe asks them to do.

So I wonder when it comes to legitimacy, isn't it still the case somehow that it remains mainly with the nation state that people see our government shows, and we can vote them out if we don't like it, but at least we follow what we chose rather than what Europe tells us to do. Thank you.

PRIME MINISTER VERHOFSTADT: Yes, that's mainly the problem. You cannot have a common currency and then lose coordination of your economic policies. The other possibility is that you have a big budget. If you have a big budget, 24 percent, then these government policies are the basis for your currency. You don't have it because 1 percent -- let's be honest, it's not 1 percent because 39 percent of this 1 percent is going to common agricultural policies. If you look really to the amount available for common policies beyond the common agricultural policies, yes, it's at 0.6 percent of European GDP. So that's the reason why we need full discipline and solidarity, and we need to go in the same direction. That's the reason why. If you can't have a big budget in Europe you don't need to have these stability pact rules in the same way as we have them now. So a loose coordination of economic policies doesn't work.

That we have seen. I was for ten years Lisbon Strategy, 2020 Strategy. We shall become the most competitive, now rich economy of the world. That was the objective. Printing paper, yes, that it was. It was nothing else than that -- best practices, peer review, benchmarks, forget it. That's not working at all. That's one bad moment in your parliaments with your bad results, and the next day you go further.

So that's the reason why we need what I call a convergence policy. A convergence policy is, in my opinion, the step that we have to make in the coming two years inside the economic and monetary union. The first policy is like deciding on a motor rate. And then this motor rate, not too narrow, but not a real motor rate where you can have ten cars at the same time, but you have a left side and a right side. The left side is to avert social dumping; the right side is to guarantee your competitiveness. It's a motor rate defining minimum and maximum values, and every European country, every economy inside Europe, has to follow that path. It's not harmonization. They can choose what they want. They can take the left side. They can take the right side. But they have to all go in the same direction, not what's happening now, a German truck on the one side and a Greek car coming from the other side, I should say.

But that's happening now, divergence of European economies. They have to converge the European economies. And if necessary, you give them sticks for that. You give them carrots for that. But you need to do that. And what is then the responsibility on the democratic level? That responsibility is still in the nation states for the implementation of these convergence policies.

And what is the democratic accountability of the motor rate as such? That's on the European level, and it exists. A European Parliament is elected. I was elected. I got 600,000 votes in the last election in my constituency. But the problem is that we have to develop this. Who's Olli Rehn? Olli Rehn is a member of the

Commission. He's Finnish. He has a lot of humor. You don't think so, but he has a lot of humor I can tell you. I know him personally, even being Finnish. So that said, we need to change the system so that there's a real democratic accountability. And you need transnational list and you have to have people and an elected president of the Commission so that he is responsible before the public opinion. That is the case in any country like in the U.S. If you go for Senator, you also have responsibility, not to talk about the President elected by everybody.

Then on the first issue, how to convince people, and because this is a jump forward, this is not little steps. I think there are two things. First of all, we need again European politicians who are developing a vision about this and going to these elections in 2014 defending that vision. I always think that politicians can create public opinions. That is not so that, unfortunately, politicians have always to follow public opinions. It's not true. People are looking to politicians, are listening to politicians, and if a politician can develop a vision, I think that he can create and sell public opinion for it. Certainly in this environment of today because of the euro crisis, because of the euro crisis people again are -- there are a number of people who say yes; maybe more European integration is what we need. Otherwise it's not possible to have a common currency.

So I'm -- there are many people who say oh, let's hope that the crisis is over tomorrow. I hope also that the crisis is over tomorrow, but this crisis helps to create a European public opinion who is aware of the problem and we're saying that we need -- and you have the opposite naturally also, the euro skeptics, the nationalists, the populists, who are telling the people we have to retreat behind our national borders to protect ourselves in a globalized world. And I think there is a case to make in 2014 with success to say exactly the opposite. You need to regain your sovereignty on the

European level. Do not listen any longer to those who say oh, national sovereignty, we'll lose our national sovereignty. It no longer exists, national sovereignty in Europe. It does no longer exist because of the euro. Ask the Greeks what national sovereignty is, ask the Spanish what national sovereignty is. We have to regain sovereignty, regain sovereignty on the European level, a de facto interest in a world changing completely every day, competing with what? With China? It's not a nation. China's a continent. It's a civilization. India is not a nation. India is a continent -- 2,000 ethnics, 20 different languages, four big religions. And then we're still thinking in terms of the 19th century. That is our problem. And I think you can make a case on that in the next elections and win with it. If you don't try, you can never win it.

MR. FRUM: Do you have time for one more question?

PRIME MINISTER VERHOFSTADT: Yes.

MR. FRUM: Ma'am.

SPEAKER: Thank you. Clara O'Donnell, nonresident fellow at the Center on U.S. and Europe here at Brookings and a senior fellow at the Center for European Reform in London. I had a question on Britain's future ties with the EU and was wondering to what extent do you think there might be willingness amongst other EU member states to allow the U.K. to renegotiate its current arrangement. And if it doesn't and if it were to leave, how costly might this be for the EU? Thanks.

PRIME MINISTER VERHOFSTADT: There's an infinite rating associated of a membership is impossible. If you do that, you have 27 infinite renegotiations and 27 different memberships in the Union. That doesn't work. We have already that problem for the moment. We have Europe of the 6, the 9, the 11, the 12, the 15, the 17, the 25, and the 27, and in a few days, we are with 28. You know the 25, the European Pact. The 17 is the euro where you have the Europe of Schengen. You have the Europe of 9, that's to start an enhanced cooperation in the European Union. You have the Europe of 12, that's to start with a fiscal compact, and so on and so on. And I'm not speaking now this morning about updates and doubts and the special regimes that exist. That cannot work. And so even though there were renegotiation, that shall only worsen the debt problem.

What shall happen is a collective renegotiation about the treaty, about the fundamental law of the union when in 2015 after the next European elections we shall start again with the convention like we launched it with the declaration from Larkin a decade ago. And while I hope that this negotiation can do is to discuss a fundamental law for the union, so what the Germans are calling a (speaking German) for the union, and then every country can decide, like it was the case with the four states in 1787 and Rhode Island was the last who said yes to this. So the same has to happen or so in Europe to make things clear and to stop this Europe al carte that cannot work in the future.

MR. FRUM: You forget we had an attempted renegotiation in 1861.

PRIME MINISTER VERHOFSTADT: Yes. Well, that was not very successful.

MR. FRUM: Oh, no, but it was very decisive.

Would you all thank the Prime Minister for his time and his candor. It was considerable.

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