Lucas Papademos: The new EU member states - convergence and stability

Opening address by Mr Lucas Papademos, Vice President of the European Central Bank, at the Third ECB Central Banking Conference "The new EU Member States: convergence and stability", Frankfurt, 21 October 2004.

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Ladies and Gentlemen,

"This is the third time. I hope good luck lies in odd numbers." So wrote William Shakespeare, and I am quoting him as a fitting reference for our conference: This is the third ECB Central Banking Conference to which I welcome you all. After the ECB conferences in the years 2000 and 2002, entitled, respectively, "Why price stability?" and "The Transformation of the European Financial System", we chose as the topic of this year's conference "The new EU Member States: convergence and stability". I speak on behalf of all my colleagues on the Executive Board and all ECB staff involved in the preparation of this conference when I say that we are delighted to host such a distinguished group of academics and policy-makers here in Frankfurt.

Obviously, in 2004 - the year of the historic enlargement of the European Union with ten countries of Central, Eastern and Southern Europe - our theme is a very topical one. For that very reason it is also a difficult one: a plethora of academic conferences and gatherings of policy-makers have examined the issues related to EU enlargement. That said, I believe that the subjects and the quality of the papers to be presented, the impressive expertise and experience of our speakers, discussants, chairpersons and panellists will provide a particularly "fertile ground" to nurture fruitful debates, enhance our understanding and generate new ideas regarding the topics we will address.

So what can we look forward to today and tomorrow? The headings of the three sessions provide the framework to structure our discussions.

1. After enlargement - where do we stand?

We will start off by devoting this afternoon to the economic and structural transformation of the new EU Member States. And I am very grateful indeed that Christian Noyer has kindly agreed - at very short notice - to replace Eugenio Domingo Solans (who unfortunately could not join us) as chairman of this session. On the basis of the paper by Gérard Roland, we seek to ascertain where the new EU Member States stand today, with regard to nominal and real convergence, and in particular their institutions and market structures. I find it very useful that such a comprehensive stock-taking exercise is undertaken at this moment in time, since the accession of these countries to the Union is a distinct step marking the beginning of a new phase in their economic and monetary integration within the EU.

Looking back over the past years, it is obvious that the new EU Member States have made remarkable progress in terms of macroeconomic stabilisation. Eight of them transformed their planned economies into market economies and integrated them through trade and financial relations with the euro area. The prospect of EU accession and future euro adoption has already served as a powerful focal point and driving force for economic, monetary and exchange rate policies and has guided policy-makers as well as market participants. In that process of transformation from planned to market economies, "institutions" played a key role - and here I understand "institutions" in a broader sense as also encompassing appropriately-designed policy frameworks. Countries that have established high levels of political and civil liberties and the effective rule of law have made significant progress in the crucial area of institution building. The existence of well-designed policy frameworks has also been conducive to achieving a high degree of sustainable nominal convergence, which is the essential prerequisite for the eventual adoption of the euro by the new EU Member States. If we look at the data for inflation, long-term interest rates, and fiscal positions, it seems that already a number of the new EU countries would fulfil - at least some of - the Maastricht criteria.

But, of course, all the Maastricht criteria for nominal convergence must be fulfilled and in a sustainable manner. Moreover, it is also important to aim at real convergence - structural and institutional - as real GDP per capita levels in the new EU countries are still well below those in the euro area. Even though progress has been achieved in the areas of privatisation and product market deregulation (with the exception of utility prices) and today the relative size of different sectors (agriculture, industry and services) and the distribution of employment have converged towards EU levels, we cannot deny that there are still large differences.

A number of issues could be raised in this context, for instance, with regard to labour markets and the development of the financial sector. I believe, however, that the core message remains the same: a lot has been achieved, but many issues still remain to be tackled. Assessing the current situation and establishing in which fields further action will be required - be that with respect to further trade and financial integration, to intra-industrial specialisation or to fiscal consolidation - is of paramount importance, especially to policy-makers.

2. Economic and monetary integration

The second session tomorrow morning is devoted to international linkages and the macroeconomic performance of the new Member States, by looking at the interrelation between the processes of integration into the EU-25 and into the global economy. This may seem as a rather specific angle from which to analyse the enlargement process. But it is one that I find particularly important, not least since it counteracts the assertion on the part of some international observers that the EU is “obsessed with its own internal dynamics”.

Over the past two decades, the world economy has become increasingly integrated. The new EU member countries are particularly striking examples of this process. Those of them which were part of the former Soviet economic sphere used to form a largely isolated trade bloc, with few interactions with the world economy. Today, these countries export and import more than two-thirds of their goods and services to and from the rest of the world. They also attract significant amounts of foreign investment. Openness and international integration can lead to a dramatic improvement in economic performance through the introduction of new technologies and access to larger markets. The paper by Douglas Laxton and his co-authors provides interesting insights and helps to estimate some of the dynamics that are at work. At the same time, international integration places significant demands on a country’s economic, political and social institutions. In this context, three principal subjects would deserve, in my view, particular attention: trade, capital flows and labour mobility. I would expect that the conceptual approaches in understanding the phenomena that we are observing, as well as the concrete policy challenges related to these subjects will take centre-stage in the discussions tomorrow.

3. Macroeconomic adjustment, convergence and the role of policy

The third session tomorrow morning as well as the policy panel in the afternoon will address the questions which are probably closest to home for central bankers: What is the role of national policies, both at the micro and macro levels, in the process of economic adjustment? What are the key policy challenges for the new Member States on the road to euro adoption? And, looking ahead, what is required to ensure a successful participation in monetary union of any future new entrants into the euro area?

The paper by Jürgen von Hagen provides a comprehensive treatment of the issues at stake and will serve as a good basis for discussion. Allow me to whet your appetite for these issues with a few preliminary thoughts.

Clearly, short-term and medium-term economic prospects depend on factors such as the stance of fiscal or monetary policy, the movements in commodity prices and/or global economic activity. However, the degree of long-term economic success is ultimately determined by the progress in structural and institutional reforms. These include, for instance, the creation of a business environment conducive to investment and entrepreneurial initiative; incentives for the formation of human capital; investment in education and research; competition policy; and appropriate policies concerning labour markets and social security systems. These are significant issues that deserve attention, and not only in the EU Member States that seek to adopt the euro in the future, but also in the current euro area countries.

On the road to the euro, convergence and stability are key objectives - hence the title of our conference. I view real and nominal convergence as interdependent processes, which can be mutually reinforcing. Indeed, by fostering real convergence through structural reforms, thereby improving the supply-side of the economy through enhanced flexibility in goods and labour markets, nominal convergence will also be enhanced. Likewise, by advancing nominal convergence, anchoring inflation expectations and reducing the inflation bias, prospects for economic growth and thus real convergence will improve. The role of macroeconomic policies in general, and the stability-oriented policy framework of the Union in particular, is to make sure that the dynamics of the economic, financial and monetary integration process do not jeopardise an orderly convergence process. It is in this light that participation in the ERM II and the fulfilment of the Maastricht convergence criteria should be seen.

EU membership is not sufficient to ensure continued economic success and real economic convergence of the new EU countries with the older Member States. There is a risk that reform fatigue will set in after EU accession, because the incentive for reform may no longer be as strong as before. At the same time, I would expect further pressures for reform to come from increased competition within the Single Market which is now confronting domestic producers; from the limitations on state aid and public subsidies that are laid down in the acquis communautaire and are applied by the European Commission; and from the constraints on macroeconomic policy which derive from the objective of all new Member States to adopt the euro.

To what extent these expectations are justified and, more importantly, what can - or should - be done in order to address the challenges accompanying these processes of economic adjustment and structural reform will be discussed tomorrow. Given that the policy panel will consist of high-calibre policy-makers from both old and new Member States and from EU institutions, one does not have to be a follower of the rational expectations hypothesis to anticipate a lively debate, be that on labour and product market reform; on financial sector policies; on monetary and fiscal policies; or on exchange rate policy and the merits of ERM II membership.

Ladies and Gentlemen,

As I said at the beginning, this is the third time - the third time the ECB is organising a Central Banking conference. And I hope there is not only good luck in odd numbers. I also hope that our third conference will again offer a valuable forum to have intellectually stimulating debates, exchange insights, generate new ideas, and enhance the good contacts between central bankers and academia. Judging by the experiences of the first two conferences, I have every reason to be confident.

Thank you very much for your attention.