

Mr Duisenberg focuses on the possible future impact of the unique monetary unification in the European Union and shares some observations on the challenges facing the ECB and the EU

Speech given by Mr Willem Duisenberg, President of the European Central Bank, at the Villa d'Este Workshop in Cernobbio on 4 September 1999.

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Ladies and Gentlemen,

A great number of you are clearly familiar with the political and economic developments which led to the introduction of our new currency, the euro. I should therefore like to look ahead and focus my remarks on the possible future impact of this unique monetary unification and share with you some observations on the challenges facing the European Central Bank and the European Union as a whole.

Since 1 January 1999, the euro has been the common currency for eleven Member States of the European Union. This was rightly described as a historic event, since the completion of Economic and Monetary Union indeed marks an unprecedented degree of economic and political integration among the European countries participating in this endeavour. I am sure that the introduction of the single currency will help to further realise the efficiency and welfare gains of the Single Market, although this will probably be a gradual process, and will become apparent only over time. However, with the establishment of Economic and Monetary Union, the integration process has certainly gained a new quality. The significance of the complete and voluntary transfer of a core competency of the modern state, namely monetary policy, from the Member States to a truly European and independent institution such as the European Central Bank, can hardly be overestimated. While the years of technical preparation certainly required great efforts on the part of all involved, it is the longer-term impact of EMU which holds the prospect of the most momentous change.

The first few months of the existence of the euro have set the scene for a positive outlook. Even though external developments such as the depreciation of the euro against the dollar have attracted rather pessimistic headlines, there are, in fact, several reasons for some satisfaction. The changeover to the single currency ran smoothly, largely thanks to the diligent preparation of all involved. The European Central Bank and the Eurosystem have assumed their new responsibilities, and the monetary policy instruments and decision-making procedures are functioning well. A unified euro area financial market is developing as operators re-orient their activities beyond the borders of their previous domestic markets.

However, it is altogether natural that not all facets of the complex EMU project are as yet complete. Setting up the technical and operational framework for EMU – even if it is proving to function to full satisfaction – is not sufficient. Economic and Monetary Union cannot simply be reduced to the mechanics of a functioning single monetary policy – however important this may be. EMU also has implications for policy fields beyond those explicitly related to the management of the single currency. The interdependencies generated and reinforced by the introduction of the euro entail a shared responsibility for the common currency on the part of all euro area Member States. Inappropriate policy choices in one country can have an immediate impact on the common currency, for example, via the exchange rate.

For the euro to be a lasting success – and to win the support of all citizens – national policymakers, businesses and trade unions will have to adapt to the conditions of a single currency. Even though this will be a gradual process, facing up to the challenges of the single currency will demand a steep learning curve for all involved.

Allow me to elaborate: the European Central Bank as the single monetary authority within the euro area will have to build up and maintain a “stability culture” among the politicians and peoples of Europe. This is no easy task, despite all our efforts to explain monetary policy decisions to the public.

Most importantly, the ECB must communicate the fundamental nature of, and justification for, its Treaty mandate to maintain price stability, not least since certain misperceptions of the goals and effects of monetary policy continue to exist.

It will only be possible to fully gain the crucial support of the public for the new and so far untested currency if the ECB manages to retain its value over time. It is my firm belief that fulfilling its primary objective to maintain price stability is not only the best service which the ECB can deliver to the citizens of Europe, but also the most appropriate way of fostering the legitimacy of our new institution. In the first few months of the euro's existence we have indeed provided an internally stable currency, although the public perception of this accomplishment has often been confused by too much attention on developments relating to the euro's external value. In this context, allow me to reiterate that the ECB's monetary policy objective is the internal value of the euro and that in the longer term the euro's internal strength will also be reflected in its external value.

Our task of maintaining price stability will certainly be made easier as the ECB acquires a track record and further builds up its credibility with the markets inside and outside the euro area. In my view, this process will be greatly facilitated by a monetary policy strategy oriented towards guaranteeing price stability in the medium term, rather than responding to short-term considerations. I should emphasise that it is the ECB's independent status which will continue to allow it to stand above day-to-day pressures, to pursue a stability-oriented policy to the benefit of all citizens without the interference of short-term political objectives and to ignore short-term market developments if they are deemed to be excessive.

The ECB is a novel and unique institution and in the performance of its tasks it is still navigating uncharted waters. Take, for example, the differing impact of monetary policy on economic activity in the different euro area Member States, which demands a well-balanced and comprehensive consideration of the precise timing and magnitude of interest rate decisions. The ECB must formulate a single monetary policy for an economic area made up of 11 distinct national economic policy jurisdictions. Our monetary policy decisions must thus always be oriented towards the conditions of this currency zone as a whole, since monetary policy by its nature is one and indivisible. Precisely this is our Treaty mandate. The ECB must develop into a truly European institution and we are making good progress in that direction.

However, developing a wider perception of the euro area as an entity appears more complicated. Certainly, there are some areas where awareness of a single "euro area economy" is well developed. The financial market operators, for instance, appear to have adapted very quickly to the reality of the euro. The extensive recourse to the more favourable financing opportunities in the now more unified financial market or the ongoing consolidation in the banking sector bear witness to this shift of perception from the national to the European level. In this context, allow me to add the following observation. The development of a highly integrated euro area financial market and the ultimate establishment of a pan-European banking industry will raise the issue of the optimal organisation of supervision of the European financial sector. Today supervision is organised on a national level; financial markets are not yet fully integrated and we do not as yet have a genuinely pan-European banking industry. However, the situation is clearly dynamic.

While it remains to be seen how quickly the situation will change, this example highlights the fact that the euro area is not yet an entity itself and not yet perceived as such in some respects. Looking back on the first few months of the existence of the euro, we have witnessed that singular and isolated news and data releases from individual economies within the euro area have sometimes inappropriately been interpreted as indicators for the entire currency zone. Such inadequate analysis can produce real difficulties, especially when the markets magnify and exaggerate the effects of these misconceptions.

This phenomenon may possibly be explained by insufficient information about the new European framework. However, another reason might lie in the conduct and presentation of Member States' economic policies. It appears that Member States are still learning to communicate adequately that, in economic terms, they also consider themselves constituent parts of a larger entity and thus also regard their domestic economic policy decisions "as a matter of common concern". It is, however, encouraging to see that these deficiencies are being addressed and that efforts are being made to render

the impact of economic decision-making on the euro area as a whole visible and transparent for the markets and the public at large. Moreover, the recognition that Europe's performance depends to a large extent on its ability to take on the task of implementing real structural reforms appears to be gaining ground.

There is no alternative to orienting the conduct and the presentation of economic policies to the new framework of EMU in order to explore its full potential. It remains to be seen whether these adjustments will have institutional implications, either motivated by functional necessity or in response to the demands from our partners and interlocutors.

I should add that institutional changes will in any case be on the agenda of the EU in the coming years, not least in order to endow Europe with a capacity for decisive external action. This is a consequence not only of the momentous changes in the wider Europe, but also the projected expansion of the EU.

The European Union has launched an enlargement process of unprecedented dimensions, with 12 countries from central, eastern and southern Europe currently involved in, or preparing, entry negotiations. The prospect of EU membership and the eventual participation in EMU has galvanised these countries into pursuing economic reforms, re-orienting their trade and embarking on a difficult and sometimes painful process of disinflation.

In this context, there should be no denying that the European Union too will have to reform its institutions and decision-making structures in order to cope with a larger number of Member States. By agreeing to convene an Intergovernmental Conference next year, the Member States have taken the first steps in this direction.

So far the progress of negotiations is encouraging, and the applicant countries should be applauded for their great efforts towards meeting the economic and political entry criteria set by the Copenhagen European Council in 1993. Beyond that, it appears that the very prospect of eventual participation in EMU has also helped to establish clear policy orientations. Naturally, the ECB takes a keen interest in developments in the future Member States and has established the relevant contacts.

I should like to conclude that the ECB is well aware of the challenges ahead, and that we are still far from "business as usual" – despite the smooth and successful launch of the euro. With the establishment of Economic and Monetary Union, the EU has recorded an outstanding historical achievement, but the task of making EMU a success will be an ongoing one, and perhaps even more momentous challenges in the wider Europe are awaiting our response.

Thank you very much.