Mr Duisenberg gives some views from the European Central Bank on EU enlargement

Text of the Zolotas Lecture given by Dr Willem F Duisenberg, President of the European Central Bank, held at the Bank of Greece, Athens on 15 October 1999.

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Introduction

Ladies and gentlemen,

Let me begin by saying that it is a great honour to be invited here to speak to you on such a prestigious occasion. This is particularly so given Governor Zolotas' – or should I say Professor Zolotas' – stature as perhaps the most significant contributor to Greek monetary history over the past few decades. Indeed, during Professor Zolotas' time as Governor of the Bank of Greece, a period which, as we are all aware, extended well beyond two decades, the achievements of monetary policy were certainly quite impressive.

The Greece of the early 1950s was certainly not the same as it is today. At that time the Greek economy, suffering from large fiscal deficits and high inflation, was in urgent need of a stable currency. It is thus a great tribute to Governor Zolotas that, for many years following his arrival at the Bank of Greece, the monetary stability that had only just been achieved was both maintained and combined with a particularly rapid rate of economic growth. It is therefore not surprising that this period in Greece's economic history has so often been referred to as the "golden era of the drachma".

Of course, times change, and with them the economic and monetary environment. This was certainly the case in the 1970s when, following the collapse of the Bretton Woods exchange rate system and the explosion of oil prices, monetary authorities around the world were faced with new and difficult challenges. In many countries, attempting to meet these challenges was accompanied by a move to flexible exchange rates. However, for the most part, we Europeans attempted and eventually succeeded in treading a different path.

This was also the case here, when, in the latter years of Governor Zolotas' time in charge at the Bank of Greece, exchange rate stability was sought by pegging the drachma to the US dollar. As we all know, at that time Greece was not yet a member of the European Community. But this was also soon to change. Indeed, assisting in the successful preparation for membership of the European Community is yet another notable contribution that Governor Zolotas made to Greece's economic history.

Since that time Greece has continued to face challenges as a member of the European Community, and now of course of the European Union (EU). Greece is one of the four EU Member States which have not yet adopted the euro. It has announced its willingness to do so in 2001. In order to join the euro area, the convergence criteria with respect to inflation, long-term interest rates, public finances and exchange rate stability have to be fulfilled. Sustainable convergence is a prerequisite for adopting the euro. This is in the interest of the countries which have already introduced the euro, but even more so in the interest of new countries entering the euro area. Without having achieved sustainable convergence, the loss of the exchange rate and interest rate instrument could cause costly tensions in the economy at the expense of growth and employment. The determined efforts of Greece to achieve such convergence have to be commended. However, it is too early to reach a firm conclusion. Next year, the European Central Bank (ECB) will produce a convergence report to analyse what has been accomplished. Let me repeat and underline that achieving convergence is not a process which ends with adopting the euro. On the contrary, being a member of the euro area and being able to benefit from the potentially great opportunities that offers call for ongoing adaptation to the new environment and the new rules of the game. It is like in sports: reaching the top is difficult, but staying there is even harder.

Integrating one or more of the EU Member States which have not previously introduced the euro will be a challenge for the euro area. However, an even greater challenge for Europe as a whole lies ahead. I am referring to the enlargement of the European Union. First, I shall deal with that process in general. Then, I should like to say a few words about how the Eurosystem (i.e. the ECB and the 11 national central banks of the Member States which have adopted the euro) is meeting this challenge, in particular since EU enlargement also implies the eventual adoption of the euro by the accession countries. Before doing so, however, I should like to make clear that I am not able to repeat Governor Zolotas' remarkable performances at the World Bank some years ago, when he made speeches in English using only Greek words.

Enlargement of the European Union

Let me begin generally by saying that the forces and motivations driving the enlargement process are the very same as those that have driven the process of European integration over the past 50 years. Moreover, these forces have shown themselves to be extremely powerful, as can be seen from the remarkable events that have taken place since the Schuman declaration nearly half a century ago.

Some 50 years ago, it was already clear to Europe's political leaders that they needed to overcome the nationalism which had ultimately led to two world wars and devastated much of Europe in the first half of this century. In order to ensure a future of peace and stability they needed instead to pursue policies which would bring European nations closer together and in so doing eliminate the risk of future conflicts. This, as I believe we are all aware, was one of the original "political" motives behind European integration.

Of course, the world has changed a great deal since the Treaty of Paris, and with it the political motives driving the integration process. Nevertheless, if one draws a parallel between the world of 50 years ago and the world of today, one cannot deny that the current enlargement process is driven, at least in part, by the desire to ensure a future of peace and stability for the whole of Europe, and not just for the 15 nations which currently comprise the European Union.

Of perhaps even greater significance in today's globalising world are the "economic" forces driving European integration. This is not to say that they were not already important in the early years of the process. Indeed, just as it became apparent 50 years ago that Europe needed to break free from the ghost of nationalism, so too it became clear that the protectionism of the inter-war period also had to be abandoned. This was an essential prerequisite for restoring economic growth and improving social conditions in post-war Europe. And so it is for the accession countries today, which no doubt see their integration into the EU as a way of ensuring that the necessary conditions are created for the sustainable, long-term growth of their economies.

Of course, these political and economic forces to which I refer are very closely linked. So much so, that it is hard to imagine one without the other. This is no doubt one of the reasons why economic integration and political integration are often seen as going hand in hand.

Indeed, the lessons of history tell us that political objectives are rarely met unless they are supported by a sound economic footing. And this is where the role of a central banker comes in. As central bankers we are not politicians and nor should we try to be. Our role is to support wider economic and political objectives by creating the monetary conditions conducive to prolonged non-inflationary economic growth. In this way we can exert a positive influence on the overall external environment. But it is also true that the nature of our tasks is heavily influenced by economic and political events, and not least at present, the ongoing integration and enlargement process.

I shall return to this point in a short while. Before doing so, however, I should like to point out that there is a third factor which is not entirely political or economic, but which has nevertheless tended to reinforce the seemingly unstoppable momentum towards ever closer European integration and, more recently, enlargement. This third force stems from our common European identity, which has developed out of many centuries of shared history and cultural heritage. Here in Greece one only has to look, as it were, outside the window to see and understand this.

Until a decade ago, one might have been fooled into thinking that there were in fact two separate European identities supported by two distinct economic systems. However, this would be to deny the close ties which still existed, even under the difficult circumstances of the time, between countries both east and west of the Iron Curtain.

Events since the fall of the Berlin Wall have now shown that this difficult period did not destroy but merely delayed a process of further European integration – including both East and West – which is a natural consequence of our shared political and economic interests and our common cultural heritage.

Ever since the velvet revolutions which swept across central and eastern Europe a decade ago, it has been apparent that, as part of their difficult transition to properly functioning market economies, these countries would become increasingly integrated with the economies of western Europe. Moreover, it was clear that this process, with its ultimate objective of accession to the European Union, could not be achieved instantaneously, but would have to be extended over a period of time, in some cases a considerable period of time. No other scenario could be foreseen, given the largely uncharted path which these countries had to tread in dismantling the old system of central planning and replacing it with the structures necessary to support a properly functioning market economy.

It goes without saying that, at the beginning of the 1990s, neither an immediate nor rapid accession of these countries to the EU would have been feasible. Nor would it have been in the interests of the transition countries themselves, in particular since their economies would not have been able to survive in a competitive Single European Market. Nevertheless, there was an obvious need, even then, both to make it known that the door would be open for these countries to join when the time was right and the conditions were met, and also to give guidance and add impetus to the transition process.

For these reasons the gradual approach which has been pursued since that time has indeed been the right one with a view to successfully achieving the final objective of full accession to the EU. In this regard, agreements have been signed, institutions have been created and initiatives have been undertaken as part of a general framework for supporting the transition and accession process. Some of these have certainly played an important role and it would seem worth mentioning just a few of them.

First of all, the Europe Agreements which were signed between the EU and each of the applicant countries provide a sound and legitimate basis for economic cooperation in a large number of sectors. Since then, the Association Councils have been keeping the transition process on track by regularly examining the accomplishments of economic reforms in the candidate countries. The Joint Assessments also play a crucial role in identifying the medium-term economic policy priorities and the Accession Partnerships do likewise with regard to the establishment of priorities for EU technical assistance.

Following the tremendous efforts of the last few years, we have now arrived at a stage in which there are no less than 12 applications for EU membership currently under consideration, ten of these from transition countries. Moreover six of the 12 have already begun accession negotiations.

When addressing the issue of enlargement, we may ask ourselves what exactly should be required of a member state of the European Union and on what criteria should the eligibility of a candidate country be assessed? Of course, these are not usually questions asked of central bankers and it is certainly not my intention to provide answers to them. As I mentioned earlier, central bankers are not politicians. But, fortunately, there is no need for me to provide answers, since these issues have already been addressed within the context of the current enlargement process. I am referring here to the so-called "Copenhagen criteria". As I am sure you are aware, these criteria were formulated at the Copenhagen European Council in 1993 with a view to defining a level playing field and ensuring the equal treatment of applicant states.

The first of these criteria, generally known as the “political criterion” calls for a candidate country to have stable institutions which guarantee democracy, the rule of law, human rights, and respect for and the protection of minorities. I shall not comment on this criterion as its purpose and meaning are quite clear to us all.

The “economic criterion”, as the second of these criteria is termed, requires the existence of a functioning market economy as well as the capacity to cope with competitive pressures and market forces within the European Union. The economic reasoning which lies behind this criterion is also quite straightforward and requires little elaboration. However, I should like to add that for the accession countries, while it is no doubt a difficult and sometimes painful task, fulfilling this criterion is an essential step towards creating a solid basis for future non-inflationary economic growth.

And, finally, there is the third criterion concerning the adoption of the so-called “acquis communautaire”. This requires that a candidate country be able to take on the obligations of EU membership, including the adherence to the aims of political, economic and monetary integration. It is this last point which is of course most relevant to the Eurosystem.

EU enlargement and the Eurosystem

As I understand it, it has been decided that no new “opt-out” clauses, such as those negotiated by the United Kingdom and Denmark, shall be available to new Member States. This implies that, when joining the EU, the new Member States will have to comply with all of the requirements outlined in the acquis communautaire which relate to European Economic and Monetary Union (EMU). Moreover, following accession, they shall each have to prepare themselves for the eventual adoption of the euro. Thus it is clear that the accession process and the entry of new members into the EU will have deep and wide-ranging consequences for the ECB and the Eurosystem.

Of course, meeting the Maastricht convergence criteria is not a prerequisite for joining the EU. However, the introduction of the euro certainly puts some pressure on accession countries to make progress towards fulfilling the convergence criteria.

In fact, we might consider their progress towards adopting the euro as part of a continuum, encompassing three distinct stages and crucial steps. These are: EU membership, participation in ERM II, and eventual adoption of the euro. The first of these steps requires implementation of the EMU-related acquis communautaire. Then, on the date of accession, new Member States will join EMU with the status of “countries with a derogation”. From this point onwards, they will be expected not only to treat their economic policies as a matter of common concern, but also to be committed to the eventual adoption of the euro, which should be an objective both of monetary and of other economic policies. This is a direct result of the fact that, as I mentioned earlier, no new opt-out clauses are to be granted to the accession countries.

With the ultimate goal of adopting the euro in mind, the new Member States will, once they have achieved a sufficent degree of convergence, be expected to participate in ERM II. Following this, when the Maastricht criteria are met, the new Member States can then be expected to exchange their national currencies for the euro and become full participants in Economic and Monetary Union.

Our role as central bankers is heavily influenced by the external economic and political environment. Moreover, it is essential that we remain aware of the changes taking place and that we seek to play an active and constructive role. This must certainly be the case as far as EU enlargement is concerned.

As a result of this process, the competencies of the Eurosystem, namely monetary policy, exchange rate policy, the smooth functioning of payment systems and financial stability, will become directly relevant as soon as the applicant countries join the EU. Thus, if the challenge of EU enlargement and the subsequent enlargement of the euro area is to be successfully met, it is essential that we are prepared for it when the time comes.

For this reason the Eurosystem is already closely monitoring developments in accession countries which are directly related to its areas of competence. Naturally this is being done in cooperation with the accession countries themselves. A network of contacts has already been set up with the relevant central banks, and several bilateral as well as multilateral meetings at expert level have been convened in recent months. It goes without saying that these working relationships will be intensified over the coming months and years with a view to deepening such cooperation in areas of specific interest to the Eurosystem. In this regard, for example, a high-level meeting with the central banks of the accession countries will be held in Helsinki as early as next month.

Since the successful integration of the accession countries into the euro area will ultimately depend on the policy strategies which they adopt, the Eurosystem is already taking a particular interest in these strategies.

In this regard, it is quite encouraging that, in most cases, the monetary policies pursued are increasingly similar to those of the Eurosystem. First, they aim at achieving and maintaining price stability by supporting a disinflation process which is in some cases already fairly advanced, even if performance generally still remains out of line with EMU standards. And second, their strategies are increasingly based upon the process of using indirect and market-based instruments to control the degree of liquidity of the banking system. More precisely, these strategies include the use of standing facilities, repurchase agreements and other open market operations, and deposit reserve requirements.

With regard to exchange rate policy, the accession countries currently pursue a variety of strategies. It is not for me to comment at this stage on what might be the most appropriate exchange rate strategy for individual candidate countries. This is clearly an issue on our research agenda. However, it is clear that with their entry into the EU and the consequent liberalisation of capital movements, accession countries will become less and less able to target their exchange rate without "importing" their monetary policy from the euro area. One may therefore expect that the monetary strategies of these countries will increasingly be conducted with a view to an orderly entry into ERM II and the adoption of the euro.

The Eurosystem also has a vital interest in the proper functioning of financial systems in accession countries. This is not least the case because integration into EU structures will entail increased competition for banks and other financial institutions. Thus, our interest in this area concerns not only the general need for financial sector reform, but also, more specifically, the need to ensure the stability of the financial systems. To this end, we have already begun monitoring developments in the banking and financial sectors of accession countries, as well as their general payment systems.

Of course, in the context of compliance with EU legal and institutional requirements, the accession countries will be expected to adopt EU legislation in the area of financial services, including those related to banking, insurance and investment firms. Moreover, against the background of the Copenhagen criteria, they will also be required to meet the broader set of structural and institutional requirements necessary for the establishment of an efficient and competitive banking sector.

Nevertheless, I should like to emphasise that establishing sound and efficient banking, financial and payment systems is also an essential requirement for a proper conduct of monetary policy and therefore also for successful participation in the euro area. This is true for a number of reasons.

First, the creation of deep and liquid capital markets is a necessary step if indirect and market-based instruments involving a number of counterparts are to be used for the conduct of monetary policy. Second, in the absence of sufficiently developed capital markets, it might be difficult for accession countries to comply with the rules relating to the prohibition of privileged access to the financial system of governments. And finally, structural weaknesses in the financial system could also have implications for the monetary policy transmission mechanism, since poor competition and soft budget constraints may affect the responsiveness of banks to changes in the monetary policy stance. It is not surprising therefore that the Eurosystem has a particular interest in keeping banking and financial sector developments in accession countries under close review.

At this point I should like to recall that the Eurosystem is not part of the EU institutional framework which has been set up for the current enlargement process. Enlargement is a political decision which concerns the Member States of the European Union. However, it seems natural that the Eurosystem will become more and more involved in this process in the near future, in particular given the implications of enlargement for our main tasks and objectives. Moreover, it is clear that the Eurosystem will play an important advisory role in areas related to its competencies.

How should the Eurosystem address and view the enlargement process? Let me make a few general remarks. First, it is my view that the Eurosystem should adopt a constructive attitude towards the prospect of EU enlargement. This applies also to the participation of new EU Member States in ERM II and their eventual adoption of the euro. The Eurosystem should be prepared to advise the accession countries both in undertaking necessary structural reforms and in pursuing the stability-oriented policies which are required in order to fulfil the accession and convergence criteria. Moreover, the Eurosystem should also stand ready to cope with additional requests to provide technical assistance to these countries and, in particular, to their central banks.

A second observation is that the Eurosystem should support equal treatment as a key feature of the accession process. This implies that objective and uniform criteria should apply, in turn, to accession, participation in ERM II and adoption of the euro. The criteria related to each step of the process should be implemented in a strict and effective manner, in order to provide the countries concerned with the external constraints necessary to bring their economies in line with the respective standards, while at the same time avoiding any discrimination.

Of course, against a background of different starting points and varying degrees of economic transition, a plurality of approaches should be feasible without compromising equality of treatment. Indeed, we do not expect the candidate countries to join the EU or to adopt the euro in a single wave. However, irrespective of the individual time frames pursued, what is clear is that the accession process requires a significant amount of preparatory work on the part of all involved.

Conclusion

It is probably unnecessary for me to remind you that, whatever the Eurosystem's involvement in the enlargement process, our primary objective is and will continue to be the maintenance of price stability in the euro area. Hence, any arrangements or other forms of cooperation with accession countries must be without prejudice to the Eurosystem's independence and its primary objective.

Nonetheless, I hope that I have conveyed the message that we at the ECB and the Eurosystem at large are also aware of how the wider economic and political environment can have implications for the fulfilment of our tasks and objectives. As central bankers we do not operate in a vacuum and this is certainly the case with regard to the Eurosystem and the prospect of EU enlargement. As the Eurosystem, we stand ready to take part in initiatives on issues falling within our fields of competence.

I should like to end my remarks here. However, before I do, let me once again express my gratitude for being invited to give this lecture today. It has indeed been a great honour, in particular in view of Governor Zolotas' long and distinguished career at the Bank of Greece.